



DOCKET NUMBER 01-486-01 : STATE OF CONNECTICUT

**IN RE: THE PURCHASE OF : OFFICE OF THE ATTORNEY
SHARON HOSPITAL, INC. : GENERAL
BY ESSENT HEALTHCARE, OF :
CONNECTICUT, INC. : NOVEMBER 26, 2001**

FINAL DECISION

TABLE OF CONTENTS

FOREWORD	1
I. INTRODUCTION	3
II. SUMMARY OF DECISION	4
A. Standard of review	4
B. The Hospital's application meets the requirements of the Conversion Act provided it complies with the modifications set forth below	6
C. Summary of modifications and conditions	7
III. PROCEDURAL HISTORY	10
IV. FINDINGS OF FACT	14
A. Parties and other relevant corporate entities	14
B. The Hospital and its services	14
C. The Hospital's fiscal crisis and its attempt to remedy it	16
D. The search for solutions	17
E. The proposed transaction	19
F. The proposed tertiary care relationship between Essent CT and St. Francis Hospital	26
G. Charitable assets and the proposed conversion foundation	27
V. CONCLUSIONS OF LAW	36
A. The proposed transaction is not prohibited by Connecticut statutory or common law governing nonprofit entities, trust or charities	38
B. Sharon Hospital exercised due diligence	38
1. The Hospital exercised due diligence in deciding to transfer its assets	38
2. The Board exercised due diligence in selecting the purchaser	43
3. The Hospital exercised due diligence in obtaining a fairness evaluation	51
4. The Board exercised due diligence in negotiating the terms of the agreement	53

C. No board member, officer or key employee of Sharon Hospital has a conflict of interest with respect to the proposed transaction	56
D. Sharon Hospital will receive fair market value for its assets	58
E. The fair market value of the Hospital's assets has not been manipulated	60
F. The Financing of the transaction will not place the Hospital's assets at an unreasonable risk.	63
G. All management contracts under the transaction are for reasonable fair value	67
H. Assuming compliance with the modifications imposed below, a sum equal to the fair market value of the non-profit hospital's assets will transfer to an appropriate charitable conversion foundation	68
1. The fair market value of the Hospital	69
2. Description and quantification of the Hospital's charitable assets to be transferred to the conversion foundation	71
(a). Purpose of Attorney General's review of charitable gifts	72
(b). Documents reviewed and legal standards	72
(c). Amount stated by Hospital in application	73
(d). Hospital's charitable gifts and trusts including an analysis of their original values	74
(e). Certain gifts should have been treated as restricted	76
(f). The Hospital's free bed funds must be categorized as restricted endowment funds	79
(g). The Hospital must deduct the principal of trusts held by outside banks from the amount available to the conversion foundation	80
(h). The Hospital must omit trusts with gift-over provisions from the charitable gifts passing to the conversion foundation	83
(i). Hazel M. Peck open estate	87
(j). Future interests and their possible treatment.	88

(k)	The funds raised by the Sharon Hospital auxiliary should pass to the foundation	89
(l)	The proceeds of the nursing home sale and the proceeds of the resulting risk fund are to be accounted for and transferred to SACHF	90
3.	Evidence regarding the Hospital's ability to transfer funds to SACHF	91
4.	The Conversion Foundation	94
5.	The Amenia Landfill liability	102
6.	Changes to the proposed tertiary care relationship between Essent CT and St. Francis Hospital	106
I.	The Parties to the transaction have provided the Attorney General sufficient information and data to adequately evaluate the proposed transaction	109
VI.	MODIFICATIONS	110
A.	Prohibition Against Cross-Collateralization of Sharon Hospital's Assets	110
B.	Prohibition Against Debt Financing of Purchase Price	111
C.	Restriction of Future Sale by Essent CT and/or Essent Healthcare	112
D.	Profit-Sharing with the Proposed Conversion Foundation	113
E.	Strengthening the Advisory Board	115
F.	Appointment of Independent Forensic Accountant	117
G.	Required Changes to the Escrow Agreement	118
H.	Essent CT shall assume a portion of the Hospital's liability, if any, for costs associated with the Amenia Landfill	120
I.	Required Changes to the Tertiary Support Agreement	121
J.	Required Changes to the Hospital's Gift Analysis	122
K.	Sale of Nursing Home	125
L.	Financial Accounts	126
M.	Margaret H. Williams Fund	126
N.	Berkshire Taconic Community Foundation and the Sharon Area Community Healthcare Foundation	126

FOREWORD

I issue this report with deep appreciation to the Sharon Hospital community -- citizens, doctors and nurses, professional staff and volunteers, and all who share an unshakable commitment to this precious health care resource. Your involvement in this process has been invaluable, providing unique insight and information about the Hospital's strengths and weaknesses, its past and present, its potential for the future. Most important, your determination and dedication have enabled the Hospital to survive and serve as a vital force for life -- a place where people receive superlative medical treatment, and extraordinary caring and support.

The community has given this Hospital literally its blood, sweat, and tears. Countless individuals have given, in distinct and different ways, large and small, over the decades. Each is entitled to respect and recognition. Our common objective is to assure that these efforts have not been in vain, and that the Hospital is preserved and enhanced.

I have been deeply moved by your stories -- of lives saved, because emergency care was only minutes away; of medicine made affordable, because monetary success was a secondary goal; of professional commitment, because doctors and staff share a standard of excellence and feeling of family.

I have been keenly aware of these stories, and many others, as I have undertaken the unprecedented, difficult and demanding task of ruling on this application. The statute mandating this task imposes strictures -- barring my personal preferences and predilections from determining the outcome. But I have sought to apply the statute's provisions so as to serve its underlying values and goals. Strict conditions have been added that reflect them. Indeed, I hope to use this experience in recommending improvements in the law.

A community hospital is a public trust. This tenet is central to the statute. It has special meaning for this hospital, in light of the enormous contributions made by the community and the public's stake in its survival and success. As a public trust, its success cannot be measured only in revenues or finances. Its conversion from non-profit to for-profit status must recognize the community's continuing need for accessible, affordable health care, as well as its incalculably critical contributions in the past. Above all, the hospital must continue to be accountable to the community.

In endeavoring to serve the statute's goals, I have listened and learned, and I hope that this decision reflects your insights and perspectives. I have sought to be as fair, objective, open and evenhanded as possible.

Despite missteps and miscalculations by some management, the Hospital community has been remarkably resilient and courageous. With leadership and resources from the foundation, and conviction and commitment from the community, the mission of excellent, affordable health care can be a priority -- a mission that must be achieved.

I. INTRODUCTION

Since 1909, Sharon Hospital has been a treasured community resource of the greater Sharon area, which comprises northwest Litchfield County, Connecticut, and portions of Berkshire County, Massachusetts and Dutchess County, New York. Sharon Hospital operates as a full service acute care facility providing a broad range of health services to those communities. Like many rural hospitals, Sharon Hospital has suffered significant operating losses for at least the past five years. These losses have created the real possibility that the Hospital will be forced to close or significantly reduce its services to the public. Based on the public comment that I have received, the overwhelming desire of the affected community is to preserve the Hospital as a full service acute care facility **regardless** of its status as either a charitable hospital or a for-profit entity.

After reviewing numerous possible solutions to the Hospital's severe financial crisis, the board of directors of Sharon Hospital now seeks to sell the Hospital to Essent Healthcare of Connecticut, Inc., a for-profit health care company ("Essent CT"). By this sale, the Sharon Hospital Board hopes to prevent the demise of the institution and to preserve affordable and accessible healthcare services for the greater Sharon community.

The legislature has authorized the Attorney General, pursuant to the Conversion Act, Conn. Gen. Stat. § 19a-486 et seq., to review and investigate the application, to disapprove it if he finds that any of the criteria set forth in the Conversion Act are not met, or to approve the application with any modifications that the Attorney General deems appropriate. After a painstaking review of the entire record, including extensive public comment and evidence submitted by the parties and the intervenors, I hereby approve, contingent upon and subject to the modifications set forth in Part VI, the Hospital's application to sell its assets to Essent CT.

II. SUMMARY OF DECISION

A. Standard of Review

This administrative proceeding marks Connecticut's first experience with the proposed conversion of a charitable community hospital to a for-profit entity. My obligation as Attorney General is to review the proposed transaction according to the standards and criteria established by the legislature in the Conversion Act. *See* Conn. Gen. Stat. § 19a-486c. In sum, these criteria require me to make a number of determinations, including whether the non-profit hospital's decision to sell its assets was reasonable, whether it chose the ultimate purchaser in an open and fair process, whether it received fair market value for its assets, whether the funds generated by the sale will be transferred to a charitable foundation that will use them for the promotion of healthcare in the affected community, and whether use restrictions of any charitable asset held by the hospital will be preserved.

Very importantly, the Conversion Act does not permit me to substitute my own personal view as to whether, in general, it is sound public policy to allow charitable hospitals to convert to for-profit status, or whether this particular proposal represents the best possible choice the Hospital could have made under the circumstances.

The General Assembly has made the policy choice to permit the conversion of charitable hospitals to for-profit status. It has weighed significant concerns about the potential effect on the provision and quality of health care services available to the public, and has established the criteria a hospital must meet if it wishes to change its status. My personal view as to the wisdom of such conversions is irrelevant here.

Rather, under the statute, I must review the proposal actually presented by the Hospital to determine whether it meets the criteria established by the legislature. In doing so, the statute does

not permit me to compare the transaction presented by the Hospital to all other possible or even probable transactions that could have been negotiated, or to hypothesize whether a more diligent and focused charitable giving campaign could conceivably have solved the Hospital's financial woes and avoided the need for this conversion application.

The due diligence standard imposed by the legislature in the Conversion Act, very simply, is not particularly rigorous or demanding. My inquiry of necessity focuses on the reasonableness of the process employed by the Hospital in reaching its decisions and not on whether the Hospital has made the best possible choice. I cannot disapprove this transaction even if I believe that the Hospital could have been better managed or governed earlier in its history or that it should have made better decisions than those reflected in the conversion application presented to me. I cannot disapprove the application even if I believe that another approach was clearly preferable or the Hospital made the second or third best choice among a number of options. Instead, my obligation--one I take with the utmost seriousness--is to ensure that the Hospital's decisions were reasonable in light of all of the facts and circumstances presented. In this context, reasonableness simply means an amount of care and prudence that is ordinarily exercised by a responsible person under such circumstances. There may be many reasonable approaches to a problem, some with failings. Only one is truly optimal, but that is not the statutory standard. As always, the legislature may wish to change the standard, perhaps based on lessons learned here. In this case, we must live with the law as it is now.

B. The Hospital's Application Meets the Requirements of the Conversion Act Provided it Complies with the Modifications Set Forth Below.

Based on this standard, I conclude that the Hospital's application meets the requirements of the Conversion Act, provided that the Hospital and Essent CT comply with the modifications and conditions that I impose herein.

First, I conclude that the process employed by the Hospital in deciding to sell the Hospital's assets was reasonable under the circumstances. Sharon Hospital has been suffering significant financial losses over the past five years. These losses have required the Board of the Hospital to take significant steps to attempt to solve the financial crisis. The Hospital employed two healthcare management firms to explore the possible solutions.

After a careful process and self-analysis, the Hospital determined that its financial problems could only be remedied by either entering into a strategic partnership with another hospital or by selling the Hospital's assets. The Hospital explored the partnership option in a reasonably prudent manner, but found it fruitless. It then explored options for a sale by offering the Hospital's assets to a wide-range of buyers on the open market. Only at the end of this process did it reach the conclusion that the best offer it received was by Essent CT, the proposed buyer. This decision was reasonable under the circumstances.

The Hospital also negotiated the purchase price and other provisions of the transaction in a reasonable manner. This process has resulted in the Hospital receiving a higher purchase price and greater protections for the community's healthcare needs than might have been achieved with less diligent effort. The conclusion that the Hospital exercised due diligence is strongly supported by two experts--one of them independently retained by me to review the proposed transaction and

to determine whether the Hospital exercised due diligence throughout the process. There is no credible evidence in this record that the Hospital's decisionmaking process was unreasonable.

I also conclude that the purchase price offered by Essent CT represents fair market value for the Hospital's assets. Essent CT has agreed to pay \$16.39 million for most of the Hospital's assets. Along with this amount, Essent CT has also committed to invest an additional \$8 million to improve the physical plant and equipment of the Hospital. These amounts together are greater than any other bid for the Hospital. The \$16.39 million purchase price is also greater than fair market value assigned to the Hospital by the two valuation experts, both of whom have extensively analyzed the Hospital's assets and financial condition.

Among my most significant duties is to ensure that the charitable assets of Sharon Hospital, which it has held in trust for the public, are safeguarded and used for the promotion of health care in the area served by Sharon Hospital after the sale of the Hospital to a for-profit entity. I must also ensure that any restrictions contained in these charitable gifts and trusts are protected. Provided it complies with the modifications set forth below, I conclude that the Hospital, as required by the Conversion Act, is prepared to transfer a sum equal to the fair market value of the Hospital to a conversion foundation that will provide healthcare services in the Greater Sharon Community. I am fully prepared to monitor and oversee the creation of the charitable healthcare foundation that will be created to serve a vital charitable healthcare mission in the Greater Sharon community, assuming approval also by the Superior Court. The restrictions on charitable gifts that must be followed are set forth in detail below.

C. Summary of Modifications and Conditions

The General Assembly has assigned me significant responsibility to modify the terms of the transaction if necessary to serve the legislative intent and statutory mandate. This authority

derives from the legislature's clear direction that no provision of the proposed transaction violate the Conversion Act itself, charities law generally, or any other applicable law. Modifications must also be imposed to further the legislature's more general intent, rooted in the Conversion Act, to protect and preserve the public's interest and stake in the assets of the non-profit hospital, a significant community resource that provides essential medical services to health care consumers. Many of these consumers depend on this resource as their only source of health care, routinely or in emergencies. Only through imposing such modifications can the public be assured that the conversion of the non-profit hospital sustain charitable health care assets, which are necessary to provide all members of the community, rich and poor alike, affordable and quality medical services.

Consequently, although I approve the Hospital's application, that approval is contingent on a number of modifications that must be made to the proposed transaction to ensure that the interests of the public and requirements of the statute are met. These modifications, which are more fully described in Section VI, include the following:

1. Essent CT and Essent Healthcare, Inc. are prohibited from using the Hospital's accounts receivable and other assets as collateral for borrowing money for expenditures that are not directly related to Sharon Hospital, such as other hospitals owned by Essent Healthcare or its other subsidiaries.

2. Essent CT is required to finance the transaction only through the use of equity financing--without any debt financing, which would saddle Essent CT with costly debt servicing.

3. Essent CT is prohibited from selling, leasing or otherwise transferring ownership and/or control of Sharon Hospital to a third party within the first three years from the date of the completion of the sale. Essent CT is also prohibited from selling, leasing or otherwise transferring

ownership and/or control of Sharon Hospital within the fourth or fifth year after the completion of the proposed transaction unless it establishes to the satisfaction of the Attorney General that it has made capital expenditures in Sharon Hospital in an amount not less than \$8 million dollars.

4. Essent CT must agree to share with the proposed conversion foundation all net earnings in the following amounts during the first ten years after the closing of the sale of the Hospital to Essent CT: If the net earnings of Essent CT exceed 7% per annum of total revenues, twenty-five percent (25%) of the amount of net earnings in excess of 7% of total revenues, as based upon and determined by the report of an independent auditor, shall be transferred to the conversion foundation at the end of Essent CT's fiscal year.

5. The Advisory Board of Trustees must be given a more significant and meaningful role so that the Hospital's service area will have a greater voice in the strategic direction of the Hospital when owned by Essent CT.

6. Sharon Hospital and Essent CT must submit, at the time of the closing, to a review by an independent forensic accountant, chosen by the Attorney General, to ensure that all money required to be transferred to the conversion foundation pursuant to the Asset Purchase Agreement is transferred. Essent CT and the Hospital must agree to be bound by any adjustments made by the independent forensic accountant to the amount of net proceeds to be transferred pursuant to the "Adjusted Working Capital" formula set forth in the Asset Purchase Agreement.

7. The Escrow Agreement must be modified to make clear that the proposed conversion foundation is entitled to receive funds remaining in the account at the end of the specified period.

8. In addition to the other funds set aside in escrow, \$1,000,000 must be placed in the escrow fund at the closing to cover the potential liability for environmental conditions at the

Amenia Landfill, and Essent CT must assume the Hospital's liability, if any, in excess of \$1,000,000.

9. The tertiary care agreement between Essent CT and St. Francis Hospital must be modified to ensure full access to reproductive health services at Sharon Hospital.

10. The transactional documents must be modified to properly account for the Hospital's charitable assets that are to be transferred to the conversion foundation.

11. Sharon Hospital must clarify transactional documents related to the recent sale of a nursing home by Sharon Corporation in order to ensure that all available proceeds from that sale are transferred to the proposed conversion foundation.

12. The structure of the proposed conversion foundation must be modified to ensure its long-term independence from the Berkshire Taconic Foundation so that the conversion funds will be used in the manner required by the statute.

III. PROCEDURAL HISTORY

On February 1, 2001, I received Sharon Hospital, Inc.'s "Notice and Application" to sell the Hospital's assets pursuant to Conn. Gen. Stat. § 19a-486 *et seq.* After reviewing the application, I notified the Hospital, on February 20, 2001, that the materials submitted were insufficient to fulfill the legal requirements of "notice" under Conn. Gen. Stat. § 19a-486a(b) and described the ways in which the materials filed were deficient. The Hospital responded on March 8, 2001, with a letter explaining certain matters and asking for further clarification regarding the deficiencies, which I provided shortly thereafter.

On April 25, 2001, the Hospital submitted additional information and documents to supplement its February 1, 2001 application. On May 1, 2001, I notified the Hospital that its submissions, taken together, constituted formal statutory "notice" of a proposal to sell certain of

the Hospital's assets to Essent CT. For purposes of the statutory time period established by § 19a-486b(b), my review was deemed to have commenced on April 25, 2001.^{1/}

Seven groups petitioned me to be named as intervenors in the proceedings: the Ombudsmen For Sharon Hospital; the Berkshire Taconic Community Foundation, Inc.; the Coalition for Choice; the Permanent Commission on the Status of Women; Physicians for Sharon's Future; the Community Association to Save Sharon Hospital; and the Connecticut Children's Medical Center. On June 29, 2001, I granted, with various limitations, all seven groups intervenor status.

On June 12, 2001, as required by Conn. Gen. Stat. § 19a-486e, the Commissioner of Health Care Access and I jointly conducted a public hearing regarding the proposed sale of the Hospital to Essent CT. The joint public hearing was held in Lakeville, Connecticut, which is within the primary service area of Sharon Hospital. Many citizens spoke at the hearing or filed written comments regarding the proposed sale.

On June 4, 2001, I served interrogatories and document requests on the Hospital, pursuant to Conn. Gen. Stat. § 19a-486c(b)(1) and (2). A second set of discovery requests was served on the Hospital on June 28, 2001. The Hospital submitted responses to the discovery on various dates between July 9 and August 30, 2001. I also served discovery requests on the Hospital's thirty-two officers and directors on June 6, 2001. Each of the officers and directors of Sharon Hospital responded individually on various dates between June 11 and August 2, 2001.

I also conducted discovery from third parties. United Methodist Homes, Inc. was served with discovery requests on June 21, 2001, regarding its purchase of a nursing home formerly

^{1/} On May 14, 2001, I designated Assistant Attorney General Eliot Prescott as the presiding hearing officer for this proceeding.

owned by Sharon Healthcare, Inc. United Methodist Homes, Inc. responded on July 16, 2001. Saint Francis Hospital and Medical Center ("St. Francis") was served with discovery requests on July 20, 2001, regarding the proposed Tertiary Support Agreement and other agreements by and between Saint Francis and Essent CT. St. Francis responded on July 30, 2001.

On June 20, 2001, I granted, with Essent CT's consent, the Hospital's motion for extension of time to respond to discovery and to extend the 120-day statutory review imposed by Conn. Gen. Stat. § 19a-486b(b). The extension was granted until September 15, 2001.

The Commissioner of the Office of Health Care Access (OHCA) held an adjudicatory hearing at the Legislative Office Building in Hartford on July 10, 2001. OHCA held a second adjudicatory hearing on August 29, 2001, at which time its portion of the formal record was closed.

On August 14 and 15, 2001, at the Sharon Town Hall, Sharon, Connecticut, the Office of the Attorney General conducted an adjudicatory hearing at which testimony was heard from the parties and intervenors, as well as from witnesses called by me.

On July 24, 2001, pursuant to Conn. Gen. Stat. § 19a-486c(b), I petitioned the Superior Court, Judicial District of Hartford, seeking enforcement of portions of the discovery requests served upon Sharon Hospital, Inc. on June 4, 2001. Through this action, I sought to compel the Hospital to produce, *inter alia*, the "work papers" and supporting documentation relied upon by the investment banking firm, Merrill Lynch, to issue the "fairness opinion" contained in the Hospital's conversion application.

On August 8, 2001, I issued a subpoena duces tecum to Merrill Lynch ordering it to appear at the August 14, 2001 adjudicatory hearing held by the Attorney General and to produce at that hearing its fairness opinion "work papers." On August 23, 2001, I instituted an

enforcement action in Hartford Superior Court to compel Merrill Lynch to produce the materials sought. Pursuant to Conn. Gen. Stat. § 19a-486b(b), the enforcement actions instituted by me tolled the 120 day statutory time period, which had been extended until September 15, 2001.

Following the adjudicatory hearing, the parties and intervenors filed additional evidence and written comments on various factual and legal issues. I also received into the record additional evidence submitted by third parties.

By order dated August 6, 2001, I took administrative notice of the complete record of the related OHCA proceedings. No party or intervenor objected. By order dated August 13, 2001, I also admitted into the record of this adjudication all of the discovery produced to me during the course of the discovery phase of this proceeding. No party or intervenor objected.

On August 20, 2001, the presiding hearing officer entered an order formally closing the evidentiary record in this case, effective August 30, 2001. On October 29, 2001, the hearing officer issued a proposed final decision approving the sale, subject to a number of modifications and stipulations. I received written briefs from various parties and intervenors addressing the proposed final decision. On November 9, 2001, I heard oral argument from the parties and intervenors at the Sharon Town Hall.

IV. FINDINGS OF FACT

I hereby make the following findings of fact:

A. Parties and other relevant corporate entities.

1. Sharon Hospital is a full service, charitable, acute care hospital located in Sharon, Connecticut. The Hospital is currently organized as Sharon Hospital, Inc., a Connecticut, non-stock, non-profit corporation. The Hospital provides healthcare services to patients from approximately 22 towns in the northwest corner of Connecticut, eastern Dutchess County, New York and southwestern Massachusetts. Sharon Hospital has tax exempt status as a public charity under I.R.C. Section 501(c)(3).
2. Sharon Hospital, Inc. owns the physical plant of the Hospital, and the real estate upon which it sits, at 48 and 50 Hospital Hill Road.
3. Sharon Corporation, located at 50 Hospital Hill Road in Sharon, Connecticut, is the parent corporation of Sharon Hospital, Inc., West Sharon Corporation, and Sharon Healthcare Inc. It is a Connecticut, non-stock corporation that holds and administers the charitable gifts and endowment of Sharon Hospital, Inc.^{2/}
4. Sharon Corporation has tax exempt status as a public charity under I.R.C. Section 501(c)(3). Sharon Corporation owns the following real estate in Sharon: 11 and 13 Hospital Hill Road, 64 Amenia Road, King Hill Road, 82 Amenia Road and 1 Low Road. The Corporation also owns 3712 Route 44, Mabbetsville, N.Y.
5. The Sharon Hospital Foundation ("SHF") was a Connecticut non-stock corporation organized for the charitable purpose of holding and administering the charitable gifts and endowments of Sharon Hospital. SHF continues to have tax exempt status as a public charity under I.R.C. Section 501(c)(3). SHF merged with Sharon Corporation in fiscal year 1996 and all of the Foundation's assets were transferred to Sharon Corporation as of the effective date of the merger.
6. West Sharon Corporation is a Connecticut stock corporation and a wholly-owned subsidiary of Sharon Corporation. West Sharon Corporation is organized for the purpose of holding and managing real estate related to Sharon Corporation, Sharon Hospital Inc. and Sharon Health Care Inc. It owns the following real estate: 33, 25 and 29 Hospital Hill Road, 40 Amenia Road in Sharon, CT, and 3360 Route 343 in Amenia, N.Y.

^{2/} These funds are held in accounts with the following names: the Depreciation Fund, the Unrestricted Fund, the Endowment Fund, the "Sharon Hospital Margaret H. Williams Fund", the "Sharon Hospital Foundation EMT Fund". In addition, Sharon Corporation holds and administers the assets of the Sharon Hospital Foundation.

7. Sharon Healthcare, Inc. is a Connecticut non-stock corporation which until recently owned and operated an 88 bed skilled nursing and short term rehabilitation facility (the "Nursing Home") located on Hospital Hill Road, Sharon, CT. Sharon Healthcare Inc. has tax exempt status as a public charity under I.R.C. Section 501(c)(3). On or about March 1, 2001, Sharon Healthcare, Inc. and Sharon Corporation entered into a sales agreement with United Methodist Homes, Inc. ("UMH") of 580 Long Hill Avenue, Shelton, CT, to sell to UMH the Nursing Home, and an additional 7.5 acre parcel of land with an address of 82 Amenia Road, Sharon, CT.^{3/} Pursuant to the Application, the net proceeds of the sale of the Nursing Home and 82 Amenia Road property to UMH will be added to the funds to be transferred to the proposed conversion foundation.

8. Essent Healthcare, Inc. ("Essent Healthcare") is a Delaware for-profit corporation having its principal place of business at 3100 West End Avenue, Suite 900, Nashville, Tennessee. Essent Healthcare is engaged in the business of owning and operating community hospitals.

9. Essent Healthcare of Connecticut, Inc. ("Essent CT") is a Connecticut stock corporation that is a wholly owned subsidiary of Essent Healthcare. Essent CT has been organized for the purpose of purchasing Sharon Hospital, Inc. and related assets in the proposed transaction.

B. The Hospital and its services

10. The Hospital is licensed for 78 general hospital beds and 16 bassinets, including 41 medical surgical beds, 11 intensive care/critical care unit beds, 8 obstetric and gynecological beds, 6 pediatric beds, 16 newborn nursery beds and a 12-bed inpatient/partial hospitalization geriatric behavioral medicine unit.

11. The Hospital provides a broad range of healthcare services, including 24-hour emergency care, magnetic resonance imaging (MRI), computerized axial tomography (CAT), ultrasound imaging, nuclear medicine, mammography, oncology, cardiopulmonary services, laboratory services, obstetrics/gynecological services, physical, occupational and respiratory therapy and outpatient surgery.

12. Sharon Hospital is a non-sectarian hospital that historically has provided a broad range of reproductive health services.

13. Sharon Hospital's primary service area includes the Connecticut towns of North Canaan, Salisbury, and Sharon. The Hospital's secondary service towns in Connecticut include Kent, Canaan, Cornwall, Warren, Winchester/Winsted, Goshen, Torrington and Harwinton. The Counties of Dutchess and Columbia in New York State are also part of Sharon Hospital's service

^{3/} Pursuant to the Agreement between Sharon Healthcare, Inc., Sharon Corporation and UMH, an escrow account called the "Risk Fund" containing \$1,250,000 was established at a June 1, 2001 closing. The funds will be held for five years for the purpose of covering the cost of certain contingencies. Forty-five days after the close of the five-year escrow period, all money remaining in the Risk Fund escrow account will be distributed to the Seller, and then to the resulting conversion foundation.

areas. Primary service towns in these New York counties are Dover Plains/Wingdale, Amenia/Wassic, Millerton/Northeast, Millbrook/Washington and Pine Plains. Secondary service towns are Stanfordville and Ancramdale/Copake.

14. For many residents in the primary service area of the Hospital, the next nearest hospital is approximately a 45 minute drive from their homes. During the winter months, drive times may be even longer due to poor road conditions.

15. Approximately 43% of Sharon Hospital's revenue is generated by Medicare fee-for-service patients. Many of these elderly patients are ill equipped to travel extended distances to receive medical care.

C. The Hospital's fiscal crisis and its attempt to remedy it

16. Sharon Hospital has been losing money for at least the last five years. For the years 1996 through 2000, Sharon Hospital suffered losses of \$1,370,342, \$703,036, \$4,538,591,^{4/} \$4,869,988 and \$2,389,255, respectively. For its fiscal year ending September 30, 2001, the Hospital is currently projected to show an operating loss of \$2.73 million. These operational losses have significantly impacted the Hospital's ability to provide services to the community in a manner that is consistent with its mission.

17. Among the factors contributing to these losses are reduced reimbursements from private and public payors, as well as reductions in inpatient hospital utilization rates mandated by the government and managed care providers.

18. In addition to reimbursement issues, certain internal factors have exacerbated the Hospital's financial condition. The Hospital's physical plant desperately needs a large infusion of capital. The Hospital's aging physical structures make cost reduction difficult because frequent and costly repairs are necessary. Unless the Hospital upgrades its facilities, maintenance, energy and operational costs will continue to grow, greatly compounding its already poor financial situation.

19. In 1997, Sharon Hospital obtained a Letter of Credit from the Bank of Boston to support bonds issued by CHEFA to finance expansion of the Hospital. Sharon Hospital has not met the terms of its debt covenants and is technically in default. In October 1999, Bank of Boston merged with the Fleet Bank, and Sharon Hospital's Letter of Credit was assumed by Fleet Bank. Fleet Bank has put increasing pressure on the Hospital to cure the defaults and retire the debt. The Hospital has been able to negotiate a series of forbearance agreements with Fleet Bank due to the proposed transaction with Essent CT. With each renewal of the Forbearance Agreement, the Hospital must pay an additional \$20,000 fee to Fleet Bank.

20. Sharon Hospital's deteriorating financial condition over the years led to three downsizing initiatives. This reduction in staff, coupled with less than optimal professional management of the

^{4/} The 1998 operating deficit would have been even greater but for a one-time unrestricted gift of \$1.85 million applied to reduce the operating budget.

Hospital, resulted in diminished productivity, poor staff morale and high staff turnover. The combination of these factors has impeded the Hospital's efforts to provide care to the community consistent with its mission.

21. Sharon Hospital's problems were further compounded when it replaced its computer system in April 1999. The conversion was unsuccessful, resulting in the inefficient operation of the Hospital's business office. Staff could not keep up with billing and collection demands. This led to significant bad debt losses over several years. The repercussions of this unsuccessful computer system conversion are still being suffered.

22. In response to increasing concerns over the Hospital's continued operating losses and decline in inpatient activities, in June of 1998, Sharon Hospital retained the health care consulting firm of Nolan & Bober Associates, Inc. ("Nolan & Bober"). Nolan & Bober was engaged to assist the Hospital in developing a financial strategic plan, as well as to prepare a projection of the Hospital's financial performance through 2003.

23. Nolan & Bober gathered and analyzed the following data: historical financial data for Sharon Hospital, historical financial data for competing hospitals, patient origin and utilization data for both New York State and Connecticut, historical and projected population data for all cities and towns in Sharon Hospital's primary and secondary service areas, physician data including office locations and numbers of physicians by both specialty and subspecialty in the Hospital's service area, and general utilization trends in the health care industry. Nolan & Bober also analyzed inpatient utilization and trends in managed care penetration. It considered Sharon Hospital's current market share, the geography of the area, and the potential impact that changing Sharon Hospital's market share would have on inpatient utilization.

24. After analyzing the data, Nolan & Bober projected that inpatient utilization in Sharon Hospital's service area would continue to decrease and that available patient days would be less than the number the Hospital would require to break even.

25. Nolan & Bober recommended to the Board that the Hospital reduce operating costs in the short term in order for the Hospital to continue its current range of services. Furthermore, Nolan & Bober strongly recommended that the Hospital seek a partnership with another entity in order to ensure the Hospital's long term viability. Such a partnership would result in lower operational costs due to shared overhead costs. Moreover, it would lead to an increase in clinical services as well as enhanced future affiliation opportunities.

26. In response, the Hospital implemented several cost reduction measures that included reductions in its labor force and an overhaul of its patient financial services in order to enhance the billing and collection functions.

D. The search for solutions

27. Despite these cost reduction measures, Nolan & Bober projected that Sharon Hospital would continue to generate a several million dollar deficit each year. That firm concluded that

cost reduction alone would not ensure the Hospital's long-term viability. Nolan & Bober recommended that Sharon Hospital explore alternatives to continuing to operate as an unaffiliated independent hospital. The Board of the Hospital agreed with this recommendation.

28. Representatives of the Hospital met with New Milford, Vassar Brothers and Charlotte Hungerford Hospitals, Albany Medical, Berkshire Health System and St. Francis Hospital (Poughkeepsie, NY) to discuss strategic partnering options. These discussions were not productive due to differences in mission and the potential partner's own internal problems.

29. Sharon Hospital recognized that it needed a facilitator who was familiar with the partnering process. After interviewing five firms to determine which could help the Hospital with its search for a partner, the Hospital chose Cambio Health Solutions, LLC ("Cambio").

30. In addition to facilitating the partnering process, Cambio also performed an immediate fiscal assessment for the Hospital. Cambio made recommendations similar to those offered by Nolan & Bober: in order to ensure its long term viability, the Hospital desperately needed to raise capital and reduce operational costs.

31. On February 26, 2000, the Board voted to proceed with the partnering process and Cambio was asked to put together a comprehensive Request for Proposal ("RFP") for the Hospital.

32. The RFP prepared by Cambio specified that Sharon Hospital would entertain all types of proposed transactions, including a lease, joint venture, partnership, merger, or outright sale, with both non-profit and for-profit entities.

33. Cambio developed a list of potential strategic partners from which to solicit proposals. The RFP was distributed to fifteen parties that spanned both for-profit and not-for-profit sectors. These included: Community Health Systems ("CHS"), Essent Healthcare, St. Francis (Hartford, CT), Charlotte Hungerford Hospital, New Milford Hospital, Province Healthcare, Doctors Community Healthcare, Kurron Shares of America, Health Quest Systems, Hartford Hospital, Columbia Health, Tenet Health Care, Vanguard, Albany Medical Center, St. Francis (Poughkeepsie, NY), and Quorum.

34. Of the regional hospitals sent RFPs by Cambio, Hartford Hospital, St. Francis Hospital and Medical Center ("St. Francis"), Vassar Brothers Hospital, Charlotte Hungerford Hospital, and New Milford Hospital expressed initial interest.

35. Of the fifteen entities that received RFPs, ten parties entered into confidentiality agreements with Sharon Hospital to permit additional discussions: Community Health Systems ("CHS"), Essent Healthcare, St. Francis (Hartford, CT), Charlotte Hungerford Hospital, New Milford Hospital, Province Healthcare, Doctors Community Healthcare, Kurron Shares of America, Health Quest Systems and Hartford Hospital.

36. Of the ten potential bidders that signed confidentiality agreements, only three parties actually offered bids for the Hospital: Essent Healthcare, CHS and Vassar Brothers. The three bidders made presentations to the Board on May 12, 2000. Essent Healthcare made a second presentation on June 10, 2000.

E. The proposed transaction

37. The Board selected the proposal submitted by Essent Healthcare and entered into a letter of intent with it. The Board appointed a special committee to negotiate the terms of a proposed Asset Purchase Agreement.

38. The Board retained Merrill Lynch Pierce Fenner & Smith Inc. ("Merrill Lynch") to prepare a fairness evaluation of the Asset Purchase Agreement subsequently negotiated between Essent Healthcare and the Hospital. To assess the fairness of the terms of the Agreement to the non-profit Hospital, Merrill Lynch performed an extensive financial analysis of the value of the Hospital's assets.

39. Merrill Lynch concluded that the fair market value of the Assets was \$9.3 to \$10.4 million (as of October 14, 2000), and that the terms of the proposed Agreement were fair to the non-profit hospital.

40. On or about October 14, 2000, Sharon Hospital entered into an Asset Purchase Agreement ("Agreement") with Essent CT. Pursuant to the Agreement, Essent CT proposes to buy many of the assets of Sharon Hospital. Among the "Included Assets" are:

- A. All personal property, including equipment, furniture, fixtures and vehicles used in connection with the operation of Sharon Hospital;
- B. To the extent assignable or transferable, all licenses, certificates of need and permits;
- C. All real property, except 82 Amenia Road;
- D. All accounts receivable of Sharon Hospital arising from patient services, including receivables related to Medicare, Medicaid, TriCare (the U.S Government insurance program for uniformed services) or other third party government payors . . . ;
- E. Sharon Hospital's interest in certain leased property;
- F. To the extent transferable, Sharon Hospital's interest in certain contracts and agreements, including managed care contracts, Medicaid participation agreements, Medicare provider numbers and third party contracts;

- G. Goodwill and intellectual property, including the right to use the name "Sharon Hospital";
- H. Deposits and other prepaid expenses;
- I. Inventory; and
- J. Sharon Hospital's 3.3% interest in Connecticut Hospital Laboratory Network, LLC.

41. The Agreement between Sharon Hospital and Essent lists certain assets that will not be transferred to Essent CT as part of the proposed transaction ("Excluded Assets"). Some of the Excluded Assets include:

- A. Sharon Hospital's Endowment in the amount of \$8,565,212 and unrestricted funds in the amount of \$12,042,687, both classified in the Asset Purchase Agreement as "cash and cash equivalents, including board-designated funds";
- B. Non-transferable licenses and permits;
- C. Supplies and equipment exhausted or sold in the ordinary course of business prior to the Closing;
- D. Investment securities and funds held in trust;
- E. Notes receivable, other than those specified in paragraph D of the Included Assets (above), and amounts due from third parties, including under the Connecticut uncompensated care pool and the distressed hospital fund;
- F. Real property located at 82 Amenia Road; and,
- G. Assets owned by West Sharon other than its real property.

42. In exchange for the assets, Essent CT has agreed to pay Sharon Hospital \$16,390,000. In addition, Essent CT will convey to the Hospital 1,000 shares of Essent CT's Class B Common Stock.

43. Under the Agreement, the purchase price is subject to the following adjustments:

- (a) Certain capital expenditures made by Sharon Hospital after April 7, 2000 and prior to October 14, 2000 (date of the Asset Purchase Agreement) and approved by Essent CT will be added to the purchase price.
- (b) "Adjusted Working Capital" will be added to or subtracted from the purchase price. Adjusted Working Capital will be calculated by subtracting the amount, at

the time of the Closing, of the current Assumed Liabilities (as defined below) from the value, at the time of Closing, of the current Assets, in accordance with generally accepted accounting principles. The Adjusted Working Capital will not take into account accrued sick leave of employees or FICA associated with accrued sick leave. The Adjusted Working Capital will include the estimated value of Sharon Hospital's inventory at the time of the Closing. Furthermore, the Asset Purchase Agreement provides that the Adjusted Working Capital will be further adjusted so that either (i) the Hospital will refund to Essent CT the amount of Accounts Receivable that were included in Assets at the time of Closing, but which have not been collected 180 days after the Closing or (ii) Essent CT will pay the Hospital in the event the amount collected is greater than the Accounts Receivable that were included in Assets at the time of Closing. At the Closing, the parties will enter into an escrow agreement to cover this contingency, and other post-closing matters.

(c) Ad valorem and property taxes will be prorated as of the date of the Closing.

(d) An actuarial estimate of the value of the cost of Essent CT's assumption of the Hospital's obligation to provide health insurance coverage to Sharon Hospital's retirees prior to 1994 will be subtracted from the purchase price.

44. From the purchase price, \$4,113,856 (as of August 14, 2001) will be placed into escrow ("Escrow Fund"), subject to the Escrow Agreement. This amount may fluctuate from time to time. The following distributions may be made from the Escrow Fund:

(a) A mandatory distribution of amounts payable to the Medicare Fiscal Intermediary or to the Connecticut Department of Social Services in connection with the filing of cost reports for periods ending on or before the date of the Closing. Cost Reports reflect the costs of the Hospital associated with its delivery of services to Medicare, Medicaid or beneficiaries of certain other governmental programs. These reports can result in adjustments to the reimbursements paid by such payors to the Hospital;

(b) A mandatory distribution for payment of escheat taxes;

(c) Amounts paid in connection with indemnification claims. The Asset Purchase Agreement provides that the Sellers will indemnify Essent CT for losses arising out of (i) breaches of Seller's representations and warranties, (ii) the operation of Sharon Hospital prior to the Closing, including environmental claims or claims associated with overpayments by Medicare, Medicaid, or TriCare or any third party payor, (iii) Excluded Liabilities (as defined below) and (iv) claims arising out of employee pension benefit or health or welfare plans. The Sellers also specifically agree to indemnify Essent for losses related to Medicare, Medicaid, and TriCare, and Cost Reports associated with those programs, and other third party payors. The Asset Purchase Agreement provides that Essent CT will indemnify the Sellers for losses arising out of (i) breaches of Essent CT's

representations and warranties, (ii) the operation of Sharon Hospital after the Closing and (iii) Assumed Liabilities. The indemnification obligations of either party must exceed \$50,000 before a claim can be made. The Sellers have no reason to believe that they will incur any indemnification obligation to Essent CT, other than with respect to the Amenia Landfill.

(d) While the Sellers expect that approximately half of the escrow will be used to satisfy defined Excluded Liabilities, as much as \$2,500,000 set aside in the indemnification escrow could be returned to the Sellers or their designee (e.g. SACHF) after 18 months. It is also possible that half of the monies in the escrow will be used to satisfy claims for indemnification.

45. In addition to the purchase price, Essent CT is assuming some of the Seller's liabilities and obligations, including:

A. Accounts payable as of the Closing;

B. Accrued vacation pay, sick leave and holiday pay of Sharon Hospital employees who are hired by Essent CT and FICA, FUTA, SUTA, workers' compensation and other taxes associated with those benefits;

C. Certain taxes after proration as described above;

D. Split dollar premiums owed under Split Dollar Agreements with James Sok and Daniel Dombal; and,

E. Health insurance coverage to Sharon Hospital's retirees prior to 1994.

46. The Asset Purchase Agreement lists a number of liabilities that Essent CT will not assume ("Excluded Liabilities"). The Excluded Liabilities, which the Seller must pay out of the proceeds of the sale and from certain other charitable assets, include:

A. Sharon Hospital's long term debt, including a letter of credit from Fleet Bank, supporting bonds issued by the Connecticut Health and Education Finance Authority ("CHEFA");

B. Liabilities arising out of claims for alleged acts or omissions, including claims for alleged medical malpractice, relating to the ownership or operation of the Assets which occurred prior to Closing;

C. Liabilities for periods prior to the Closing arising out of Cost Reports, or other third-party payor programs;

D. Amounts due for legal, accounting, financial advisory, closing costs and brokerage fees related to the Transaction; and,

E. Amounts due for federal, state or local tax liabilities for periods prior to the Closing or resulting from the Transaction.

47. Under the Asset Purchase Agreement, Essent CT has agreed to invest \$8 million in capital expenditures in Sharon Hospital over a period beginning on the date of the Asset Purchase Agreement and terminating five years after the date of Closing.

48. Pursuant to the Second Amendment to the Agreement, Essent CT intends to continue to offer the services that are provided by the Hospital as of the date of the Agreement.

49. Pursuant to the Agreement, Essent CT agrees to continue the Hospital's existing charitable practice of providing care to the indigent and needy, and further agrees to include this covenant in any subsequent sale of the Hospital.

50. If the proposed transaction is approved, the net proceeds from the transaction, plus the assets not being sold to Essent CT (the Excluded Assets), will be transferred to a charitable foundation. The parties proposed that the resulting conversion foundation be entitled the Sharon Area Community Healthcare Foundation.

51. If the proposed transaction obtains all regulatory and judicial approvals, SACHF will use these funds for charitable purposes consistent with the mission of the formerly not-for-profit Sharon Hospital and for the promotion of healthcare generally in the community.

52. The determination as to which nonprofit organization will ultimately receive the charitable assets of Sharon Hospital is subject to the discretion and approval of the Attorney General and the Superior Court, Litchfield Judicial District.

53. The Sharon Hospital Board recommended that the SACHF be a supporting organization of the Berkshire Taconic Community Foundation ("BTCF"), an existing Connecticut nonprofit organization based in Great Barrington, Massachusetts. Sharon Hospital, on or about October 13, 2000, entered into a non-binding Memorandum of Understanding with the Berkshire Taconic Community Foundation, Inc.

54. As envisioned by BTCF, depending on the size of the fund SACHF expects to receive, the funds will be used to support a broad range of preventive health and educational projects. According to BTCF, the purposes of SACHF would be:

A. To maintain and improve the physical and mental health of all the residents of the area historically served by Sharon Hospital, including the communities of: Canaan, Cornwall, Cornwall Bridge, Warren, East Canaan, Falls Village, Goshen, Kent, Lakeville, Lime Rock, Norfolk, Salisbury, Sharon, South Kent, West Cornwall, in Connecticut, as well as the New York communities of Amenia, Ancram, Ancramdale, Copake, Copake Falls, Dover Plains, Millbrook, Millerton, Pine Plains, Stanfordville, Taconic, Wassaic and Wingdale.

B. To improve the health of all residents in the above communities and particularly emphasize the more vulnerable populations of the poor, the elderly, the disabled and children.

C. To support a full range of projects to enhance the health of its area residents, including, but not limited to, assessments of health needs and the provision of resources to meet them, preventive health programs, education programs and special assistance to uninsured or underinsured constituents.

D. To seek and accept additional funds to enhance community health.

E. To remain cognizant of and responsive to changing health needs of the area.

F. To make grants to non-profit organizations in furtherance of its corporate purposes.

G. To make grants to federally qualified health centers and other non-profit organizations providing charity care, including charitable primary care to indigent patients in Sharon Hospital's primary and secondary service areas.

H. To work cooperatively with Sharon Hospital to ensure and augment a network of affordable and accessible health and medical care in the region; provided, however, that the SACHF will not support programs operated by or for the benefit of Sharon Hospital while it is operated as a for profit entity.

I. To expand and enhance community health care services rather than supplant existing services whether publicly or privately supported.

J. To invest, subject to the appropriate legal, tax and regulatory approval, in the acquisition of all or part of the acute care hospital facilities and operations of Sharon Hospital if the Directors of the SACHF determine that such investment is necessary and appropriate to further the goals of the overall health needs of the constituent community.

55. The language of Section J above was designed to permit the community to purchase the Hospital if Essent CT decides to sell the hospital to a third party within ten years of the close of the transaction. In that event, Essent CT must first offer to sell the Hospital to SACHF on the same terms that have been offered to Essent CT by a third party.

56. If the proposed transaction is approved, Essent CT will issue 1,000 shares of its Class B Common Stock to Sharon Hospital, Inc. (which will then transfer the stock to the conversion foundation) to facilitate a possible future repurchase of the Hospital by SACHF.

57. Pursuant to the Stockholders Agreement, Essent CT is also obligated to incur a minimum of \$8 million in capital expenditures in the Hospital within five years after the closing of the transaction. If Essent CT does not do so, it must pay the balance of the \$8 million to SACHF.

58. Essent CT's purchase of Sharon Hospital will be financed by Thoma Cressey, a private equity firm located in Chicago, Illinois. Thoma Cressey, through its \$450 million private equity Fund VI, has agreed to commit \$50 million in equity capital to Essent Healthcare, Inc. Thoma Cressey is a signatory to the Asset Purchase Agreement, as guarantor of all of Essent CT's financial obligations thereunder, including the commitment to invest \$8 million in capital improvements in the Hospital in the five years immediately after the Closing.

59. When the Notice was filed in February 2001, Essent CT represented that (1) it would pay for 2/3 of the aggregate purchase price of \$16.39 million by drawing down on its equity commitment from Thoma Cressey Fund VI, L.P. and certain other investors, and (2) that it would pay for approximately 1/3 of the purchase price with debt obtained from a third party lending source.

60. Since that time, the Hospital's continuing financial losses have led Essent CT to conclude that the Hospital will be strengthened financially if Essent CT uses all equity capital, rather than a combination of equity and debt, to pay the purchase price. At the August 14 hearing, Essent CT stated that it will pay all of the purchase price by drawing down on its equity commitment from Thoma Cressey. It also represented that it will finance one-half of the \$8 million in capital expenditures through the Hospital's cash flow and the remaining \$4 million balance through a secured financing line of credit from Heller Healthcare Finance, Inc. ("Heller").

61. On or about April 17, 2000, Essent Healthcare entered into a Loan and Security Agreement ("Loan Agreement") with Heller. The maximum aggregate principal amount of credit extended by Heller to Essent Healthcare under this Loan Agreement that may be outstanding at any time is \$10 million.

62. The Loan Agreement is in the nature of a revolving line of credit and is secured by the accounts receivable of all hospitals owned and operated by Essent Healthcare and its subsidiaries, including Essent CT.

63. Pursuant to Conn. Gen. Stat. § 19a-486c(c), I engaged the services of J. Alix & Associates to assist in reviewing the proposed transaction, including, but not limited to, determining the fair market value of Sharon Hospital's assets. J. Alix & Associates is nationally recognized as a leader in the hospital valuation business.

64. In performing its analysis of the proposed transaction, J. Alix & Associates relied upon financial information obtained from Sharon Hospital and its management, Essent CT, and from various public, financial and industry sources.

65. In addition, J. Alix & Associates relied in part upon testimony of management and members of the Board of Directors of Sharon Hospital ("The Board") in determining the procedures leading up to the negotiation of the Asset Purchase Agreement with Essent CT.

66. As part of its engagement, I asked J. Alix & Associates to conduct an independent valuation of Sharon Hospital in order to determine whether Sharon Hospital will receive fair market value for its assets. In so doing, J. Alix & Associates performed an extensive analysis of all financial data available and applied two standard valuation methodologies: the Income Approach and the Market Transaction Approach.

67. Based on its analysis using these standard industry techniques, J. Alix & Associates determined the fair market enterprise value of the Hospital to be within the range of \$10 to \$13 million dollars.

F. The proposed tertiary care relationship between Essent CT and St. Francis Hospital

68. St. Francis Hospital and Medical Center (St. Francis) is a Connecticut non-stock corporation having its principal place of business at 114 Woodland Street, Hartford, Connecticut. It is organized for the religious and charitable purpose of providing medical and hospital care. St. Francis has tax exempt status as a public charity under I.R.C. Section 501(c)(3).

69. On or about July 27, 2001, St. Francis entered into a Tertiary Support Agreement with Essent CT for the provision of certain tertiary medical care services and administrative resources at Sharon Hospital should its conversion to for-profit status be approved. St. Francis and Essent CT have also agreed to make certain clarifications and amendments to the Tertiary Support Agreement.

70. Pursuant to the Tertiary Support Agreement, St. Francis has pledged to provide Sharon Hospital tertiary resources as well as advice and assistance on a variety of other management, administrative, and educational programs, including physician recruitment.

71. The proposed tertiary care relationship is intended by Essent CT and St. Francis to be non-exclusive and does not prevent Sharon Hospital from establishing arrangements with other healthcare providers for tertiary services, including reproductive healthcare and family planning, that are not included among the tertiary services to be provided by St. Francis. The proposed agreement does not require or otherwise explicitly provide for Sharon Hospital, Essent CT, Hospital staff, or any physician with privileges at Sharon Hospital to refer patients to St. Francis.

72. Pursuant to the Tertiary Support Agreement, Essent CT and Sharon Hospital will continue to be independent organizations that are not under the control of St. Francis.

73. St. Francis is organized and operates under the sponsorship of the Roman Catholic Church and conducts its activities in accordance with the Ethical and Religious Directives for Catholic Health Care Services as adopted by the United States Conference of Catholic Bishops. These

directives prevent St. Francis from participating with Essent CT and Sharon Hospital in a wide variety of obstetrical, gynecological or reproductive services.

74. On August 23, 2001, Essent Healthcare and Essent CT, through their counsel, submitted to me proposed stipulations which they consent to be imposed as modifications to the conversion agreement. These stipulations reflect Essent CT's commitment to continue the full range of reproductive health services currently provided by Sharon Hospital, and also to enhance and improve the cost, availability and quality of these services, by entering into additional tertiary care relationships with one or more hospitals.

75. Pursuant to the Tertiary Support Agreement, Essent CT and Sharon Hospital, including their physicians, administrators and other staff, will continue to operate independently from St. Francis and will act in accordance with their own professional judgment. They will not be bound or restricted by the Catholic Directives in any manner.

76. St. Francis and Essent CT have agreed that St. Francis will not provide any physician or medical staff recruitment services for Sharon Hospital or Essent CT in the areas of obstetrics, gynecology, pediatrics, family medicine or anesthesiology.

77. St. Francis and Essent have agreed that in performing any recruitment services for Essent CT or Sharon Hospital, St. Francis shall not inquire as to the candidates' personal position or beliefs with respect to the Catholic Directives, nor shall St. Francis ask any candidates to conform with the Directives.

78. St. Francis and Essent CT have agreed that they shall not enter into an agreement in which St. Francis provides pharmaceutical services to Sharon Hospital or Essent CT unless Sharon Hospital or Essent CT enters into a separate agreement with a third party for the provision of pharmaceutical services that include the ordering, stocking, and dispensing of contraceptives, drugs and other medications necessary for the provision of reproductive health care services at Sharon Hospital.

G. Charitable assets and the proposed conversion foundation

79. The Berkshire Taconic Community Foundation ("BTCF") is a Connecticut non-stock corporation located at 271 Main Street, Great Barrington, Massachusetts. It is organized as a community foundation for the purpose of holding and administering funds for the benefit of communities in Northwest Connecticut, Dutchess and Columbia Counties, New York and Berkshire County, Massachusetts. BTCF has tax exempt status as a public charity under I.R.C. § 501(c)(3).

80. Pursuant to the provisions of the proposed agreement, the net proceeds of the sale of the Hospital to Essent CT, along with the net proceeds from the sale of the Nursing Home, and the Hospital's remaining charitable assets that have not been purchased by Essent CT will be transferred to a newly formed charitable foundation. It will be organized as a supporting organization of the Berkshire Taconic Community Foundation, called the Sharon Area Community Health Foundation ("SACHF").

81. The sum originally projected to be transferred to SACHF is set out in Figure 1 to the Application. Figure 1 is captioned "Projected Sources and Uses of Transaction Proceeds, Value of the Excluded Assets, Total to Be Transferred to SACHF As of September 30, 2000" ("Sources and Uses Table"). It states that the Net Transaction Proceeds, plus the Total [of] Other Charitable Assets plus the Total Endowment equals \$21,802,836.00. That sum includes Amounts Held in Trust by Others (\$6,399,740.00).

82. The Sources and Uses Table was updated by the Hospital as of August 14, 2001 for use at the Attorney General's adjudicatory hearings held August 14 and 15, 2001. According to the update, the Total [of] Other Charitable Assets and Endowment Available for Successor Foundation was \$23,485,785, including Amounts Held in Trust by Others of \$6,501,116.

83. The actual amount of funds to be transferred will change daily depending upon market fluctuations as they affect the Hospital's charitable assets in certain investment funds. The amount will also fluctuate based upon changes in the "net proceeds" of the sale as determined by the Adjusted Working Capital formula contained in the Asset Purchase Agreement.

84. Throughout its history, the Hospital has received numerous charitable gifts, legacies and devises from generous donors and community fundraising efforts. The charitable gifts take one of several forms:^{5/}

A. Gifts held by the Hospital. These take the form of:

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

^{5/} As part of its Notice and Application, the Hospital provided to me in table format a review of the charitable trusts and gifts of which it is the beneficiary or in which it claims an interest. The table is encaptioned "Sharon Hospital Analysis of Gift Instruments"("Gift Analysis"). This review includes a citation to, and copy of, the applicable gift instrument(s) for each endowment fund or gift (with a tab number reference to the gift instrument), a statement of the value of the original donation (following the definition of "historic dollar value" set out in the Connecticut Uniform Management of Institutional Funds Act," Conn. Gen. Stat. § 45a-527(5)), and a summary of the operative language of the gift.

The Gift Analysis was accompanied by five volumes of gift instruments. The information about each gift is numbered and tabbed. Missing from the records of the Hospital, and consequently from the Gift Analysis, and Gift Instruments was documentation of the language of an estimated eight gifts totaling approximately \$25,356.69 including those from: Everitte St. John, Henry S. Chapman, David Lloyd, Louis E. Schwab, Donaldson Brown, Settie Hirsch and Emily Whitney.

(ii). Unrestricted endowments (e.g. a charitable fund, the original gift instrument of which specifies that the sum donated is to be held and preserved as "principal", as a "fund," as an "endowment," or directs that the sum be held and invested, or added to an existing endowment fund, and further specifies that the annual income earned on said principal be applied to the hospital's "general purposes," "general expenses," "general fund," or used "at the discretion of the board";

(iii). Fully expendable gifts, not structured as endowments, to be administered and used by the hospital for restricted purposes specified by the donor;

(iv). Fully expendable gifts, not structured as endowments, to be administered and used by the hospital for its general purposes;

B. Trusts held by outside banks, a portion of the annual income of which was designated for donation to Sharon Hospital to be used for one or more of its charter purposes;

C. Future interests in charitable remainder trusts (including charitable remainder unitrusts or annuity trusts, held by outside banks or trustees, in which the Hospital has no current income or principal interest);

D. Charitable funds which Sharon Hospital or the Sharon Hospital Auxiliary raised in a manner that falls within the definition of "solicit" or "solicitation" as set out in the Solicitation of Charitable Funds Act, Conn. Gen. Stat. §21a-190a(3).

85. In response to the Attorney General's discovery requests, the Hospital provided a statement of the value of the charitable gifts listed in the Gift Analysis as of May 31, 2001 encaptioned "Sharon Hospital Funds Value Report at 5/31/01."

86. Among the gifts held by the Hospital that it has categorized as restricted endowments are the following: Northrup (Tab 16), Sherman (Tab 20), and Williams (Tab 23). The Funds Value Report states that as of 5-31-01 the total value of the principal of these restricted funds was \$277,324 and that there was no accumulated income.

87. Among the gifts held by the Hospital that it has categorized as "unrestricted endowments" are the following: Burr (Tab 4), Colgate (Tab 5), Ellison (Tab 6), Emory (Tab 7) Ensign (Tab 8), Firuski (Tab 9), Harison (Tab 10), Hart (Tab 12), H. Hatch (Tab 13), M. Hatch (Tab 14), Noble, (TAB 15) Hatch (Tab 14-A) and Milmine (Tab 14-B). The Funds Value Report states that as of May 31, 2001 the total value of the principal of these restricted funds was \$1,054,129 and that there was no accumulated income.

88. Among the gifts held by the Hospital that it has categorized as "unrestricted charitable gifts" are the following: Harrison (Tab 11), Adelman (Tab 24), J. Aiken (Tab 25), M. Aiken (Tab 26), Albisser (Tab 27), Appel (Tab 29), Arlin (Tab 30), Bame (Tab 31), Barter (Tab 32),

Bassinger (Tab 33), Bauer (Tab 34), Berry (Tab 36), Bingham (Tab 37), Bissell (Tab 38), A. Blagden (Tab 39), A. Blumenthal (Tab 41), J. Blumenthal (Tab 42), Briggs (Tab 43), Buckley (Tab 44), M. Cannon (Tab 45), W. Cannon (Tab 46), Capital Markets (Tab 47), Childs (Tab 48), Cleaveland (Tab 49), Coffin (Tab 50), Cohen (Tab 51), Colgate (Tab 52), Cowles (Tab 53), Crane (Tab 54), Culbertson (Tab 55), Daboll (Tab 56), Decker (Tab 57), DeDombrowski (Tab 58), Doherty (Tab 60), Donaldson (Tab 61), Eaton (Tab 62), Eggleston (Tab 64), Ellsworth (Tab 65), Emerson (Tab 67), Firuski (Tab 69), Ford (Tab 70), Fowler (Tab 71), Frankel (Tab 72), Frankenstein (Tab 73), Gaylord (Tab 75), Girvan (Tab 76), P. Godard (Tab 78), Goerlich (Tab 79), Gorham (Tab 80), Grinnell (Tab 81), Haan (Tab 82), Haight (Tab 83), Hall (Tab 84), Halsey (Tab 85), Hamber (Tab 86), Hamlin (Tab 87), Harriott (Tab 88), I. Harris (Tab 89), M. Harris (Tab 90), Haskell (Tab 91), Hatch (Tab 92), Hauser (Tab 93), Hawley (Tab 94), Hewat (Tab 95), M. Holley (Tab 96), S. Holley (Tab 97), Hopson (Tab 98), M. Howard (Tab 99), S. Howard (Tab 100), Hunt (Tab 101), Jendrick (Tab 102), Jessup (Tab 103), Johnson (Tab 104), M. Kaye (Tab 105), S. Kaye (Tab 106), Kirby (Tab 107) Kozlarek (Tab 108), Lee (Tab 109), Lehnert (Tab 110), Lime Rock (Tab 111), Linder (Tab 112), Loughran (Tab 114), Low (Tab 114), Lucas (Tab 115), Luce (Tab 116), Luster (Tab 117), Lyon (Tab 118), Maclay (Tab 119), Mansfield (Tab 120), McChesney (Tab 121), McDonnell (Tab 122), Mckean (Tab 123), McLane (Tab 124), McLean (Tab 125), McLellan (Tab 126), H. Mileham (Tab 127), Mileham Estate (Tab 128), Mitchel (Tab 130), A. Moore (Tab 131), G. Moore (Tab 132), G. Moore (Tab 133), M. Moore (Tab 134), J. Noble (Tab 136), R. Noble (Tab 137), Pajuf (Tab 139), Palmer (Tab 140), Parshall (Tab 141), Pitcher (Tab 143), Porzelt (Tab 144), Pulver (Tab 145), Purdy (Tab 146), M. Rathbone (Tab 147), R. Rathbone (Tab 148), Reed (Tab 149), Riley (Tab 150), G. Roger (Tab 151), L. Roger (Tab 152), Schall (Tab 154), Scheller (Tab 155), Schley (Tab 156), E. Schwab (Tab 157), L. Schwab (Tab 158), Scoville (Tab 159), Seeman (Tab 160), Selleck (Tab 161), Simmons (Tab 162), Sjoberg (Tab 163), Somarindyck (Tab 164), Sprague (Tab 165), Stone (Tab 166), Straub (Tab 167), H. Struse (Tab 168), M. Struse (Tab 169), Talmage (Tab 170), Tornquist (Tab 171), Toulmin (Tab 172), Toulmin (Tab 173), Tyler (Tab 175), Van Kirk (Tab 176), Von Ketteler (Tab 177), Wagner (Tab 178), Walworth (Tab 179), F. Ward (Tab 180), M. Ward (Tab 181), J. Warner (Tab 182), L. Warner (Tab 183), Webster (Tab 184), Whitbridge (Tab 185), Wolf (Tab 187) Zotter (Tab 188), Peck (Tab 141-A), Van Cortlandt (Tab 175-A), and Hatch (Tab 92-A). The Funds Value Report states that as of May 31, 2001 the total value of the principal of these restricted funds was \$11,505,559 and that there was \$3,333,976 of accumulated income.

89. Among the gifts historically held by the Hospital and categorized as fully expendable gifts, not structured as endowments to be held and applied by the hospital for the restricted purposes designated by the donor, are the following: Gillette (Tab 2), DeMussey (Tab 59), Eberle (Tab 63), Allen (Tab 28), Belcher (Tab 35), Z. Blagden (Tab 40), Elting (Tab 66), Fransioli (Tab 74), G. Godard (Tab 77), Ompir (Tab 138), Ryan (Tab 153), Winslow (Tab 186), Miner (Tab 129), Newell (Tab 135), Pierre (Tab 142), and Triaca (Tab 174). The Funds Value Report states that as of May 31, 2001, all of these gifts had been fully expended. The Hospital did not provide a total for these gifts.

90. The Funds Value Report also states that on August 1, 2001, a gift of \$10,000 was received from the Estate of Nelson Slater, which the Hospital has characterized as unrestricted endowment.

91. Among the trusts held by outside banks are the following:

The William G. And Mary C. Raynsford Fund, (Tab 3), which is currently held and administered by trustee Fleet Bank, N.A., and established under Article 4 of the Will of William G. Raynsford, dated March 26, 1964. Pursuant to Article 4, the rest and residue of Mr. Raynsford's estate passed to the trustee to be held in trust until the corpus reached \$250,000. At that time, the net annual income was to be distributed to two churches. If any net income exceeded \$3000 annually the excess income was to pass to Sharon Hospital for its general purposes. The will provides that if Sharon Hospital ever ceases to exist, its share will pass to two or more charitable organizations in Salisbury to be chosen by the trustee. The Raynsford Fund was augmented by a further gift under the Will of Mary C. Raynsford, dated September 23, 1959 upon identical terms.

The Jane C. Gillette Trust, (Tab 2), which was formerly held and administered by trustee Fleet Bank, and established under Articles 15 and 16 of the Will of Jane C. Gillette. Article 15 left \$10,000 in trust at Bankers Trust Company with the direction that the income be distributed to the Sharon Hospital Association for its general purposes. Article 16 placed an additional \$10,000 in trust with Bankers Trust Company with the direction that the net income be used to provide two free beds at the Hospital. In 1989, the Salisbury Probate Court dissolved the two trusts and distributed the sum of \$15,634.64 to Sharon Hospital.

The I. Kent Fulton Trust, (Tab 1), which is currently held and administered by trustee Fleet Bank, N.A., and established under Article Eleven of Mr. Fulton's Will, dated October 2, 1939, as modified by his Codicil dated December 15, 1939. Article Eleven of the Will established a trust with a corpus of \$25,000 at Hartford National Bank & Trust Co., the net income of which was to be paid annually to Sharon Hospital for its general purposes. Pursuant to the Codicil, the rest and residue of his estate was to be held in trust f/b/o his wife Elizabeth Warner Fulton and his son Wells Fulton. After the death of the survivor of them, if the son had no issue, one third of one half of the trust was to be added to the trust established under Article Eleven of his will.

The Bedelia Croly Falls Trust, (Tab 68), which was not listed by the Hospital among the trusts held by outside banks, is currently held by Co-trustees The Trust Company of the Berkshires and Attorney Mark Capecelatro. It was established under Article Third, Sections (3) and (6) of Bedeila Croly Falls' will, dated October 23, 1987. Pursuant to those sections, the net income of the trust was to be distributed to local charities in the following shares: 10% to Little Guild of St. Francis for the Welfare of Animals, Inc.; 30% to Litchfield County Association for

Retarded Children; 40% to Sharon Hospital, Inc.; 10% to Salisbury Family Services, Inc.; 10% to Salisbury Public Health Nursing Association. The Will directed Sharon Hospital to apply the income it received "for indigent individuals and families or middle class families facing financial ruin because of medical expenses." The Will contained a gift-over provision directing that should any one of these charities cease to exist, leaving no duly appointed or recognized successor, then that share of the defunct organization shall be equally divided among the remaining beneficiaries on a pro rata basis."

92. Among the future interests in certain trusts that have not ripened into enjoyment, which the Hospital has disclosed, are the following: Zelina Therese Clark Blagden (Tab 40); Richards Haskell Emerson (Tab 67); Mary W. Howard (Tab 99); Florence Emily Scheller (Tab 155); Archibald A. Talmage (Tab 170).

93. The Estate of Hazel M. Peck (Tab 141-A) is an open and pending estate, in which no distribution or order of distribution has been made by the court of probate. Under the provisions of Article Third of her will dated September 17, 1999, the residue of the estate is to be sold and the net proceeds are to pass to Sharon Hospital.

94. The Sharon Hospital Auxiliary is an unincorporated association of volunteers, which is formed as a "division of Sharon Hospital." The Sharon Hospital Auxiliary has no separate 501(c)(3) tax exempt status. Article VIII of The Amended and Restated Bylaws of The Sharon Hospital, Inc. state:

Section 1. Organization, purposes and accountability:

a. There shall be a Sharon Hospital Auxiliary consisting of one or more classes of members and one or more chapters in communities served by the Hospital.

b. The Auxiliary shall exist for the purpose of supporting the programs and goals of the Hospital through voluntary service and other appropriate activities. While the following shall in no wise be deemed to be exclusive, the Auxiliary may establish, organize and operate a hospitality shop, or other outlets such as a bargain shop for merchandising clothing and furniture. The Auxiliary may also conduct benefits, bazaars, fairs, dances and raffles to raise funds for the Hospital. Net profits from the above, or any other activities not specifically mentioned, after payment for all expenses, shall inure to the benefit to the Hospital.

c. The Auxiliary shall provide for its own organization through the adoption of appropriate Bylaws which must be approved by the Board of Trustees.

95. As of March 31, 2001, the Sharon Hospital Auxiliary held the following accounts, containing funds in the amount of \$133,276.23. These funds were generated by the Auxiliary's retail activities and other fundraising events:

Certificate of Deposit at Prudential Securities, Account No. Ouc-967334-42 in the amount of \$65,000.00;

Money Market account at New Milford Bank, Account No. 804701250 in the amount of \$13,752.64;

Operating Cash/General Fund at Salisbury Bank & Trust, Account No. 1305928610 in the amount of \$11,300.34;

Operating Cash/General Fund at Salisbury Bank & Trust, Account No. 1305928612 in the amount of \$31,922.91;

Operating Cash Gift Shop account at Salisbury Bank & Trust, Account No. 1305928610 in the amount of \$11,300.34.

96. The Hospital treats the funds raised by the Auxiliary as an "off-balance sheet" source of funds. The value of the funds, as of August 3, 2001, was \$121,976.00.

97. As part of its Application, Sharon Hospital provided to me a summary of the financial aspects of the proposed sale encaptioned "Sharon Corporation, Sharon Hospital and West Sharon Corporation Sale to Essent of Connecticut, Inc.: Sources and Uses of Transaction Proceeds and Total to Be Transferred to Successor Foundation As of May 31, 2001." ("Sources and Uses Table", updated to August 15, 2001). This table sets out the sources of the transaction proceeds (including the purchase price, additions thereto, excluded liabilities, commitments to payment of outstanding debt and retiree benefits) and adds to them net residual assets, unrestricted net assets and the total endowment. Among the items listed as part of the Endowment is a line item encaptioned "Amounts Held in Trust by Others," which totaled \$6,501,116.00. According to the Hospital's Sources and Uses Table, the total sum of \$23,485,785 is listed as "available" for the successor foundation. The above sum to be passed to the successor foundation, includes: Net Transaction Proceeds of \$2,308,845, Net Residual Assets of \$1,838,812, Unrestricted Net Assets of \$10,671,540, Amounts Held in Trust By Others of \$6,501,116, and Restricted Net Assets of \$2,165,472. The Amounts Held in Trust By Others consists of the principal of trust funds held by Fleet Bank, N.A. in the I. Kent Fulton Trust and the William G. and Mary C. Raynsford Fund.

98. The value of the principal in the I. Kent Fulton Trust, as of May 31, 2001, was \$6,219,777.80. At that time, there was accumulated income of \$5,455.09. The Hospital is an income beneficiary of the trust.

99. The value of principal of the William G. and Mary C. Raynsford Fund, as of May 31, 2001, was \$836,509.55. At that time, there was accumulated income of \$1,1622.93. The Hospital is an income beneficiary of the trust.

100. Co-trustees, Mark Capecelatro and the Trust Company of the Berkshires, hold and manage the Bedelia Croly Falls Trust established under Article Third (3) and (6) of the will of Bedelia Croly Falls. Under the terms of the will, the rest, residue and remainder of the estate was

to pass into trust. The income beneficiaries of the trust are five charities including Sharon Hospital, which receives 40% of the net income "for indigent individuals/families or middle class families facing financial ruin because of medical expenses." The will also states that should any one of these charities cease to exist leaving no duly appointed or recognized successor, then that share of the defunct organization shall be divided among the remaining beneficiaries on a pro rata basis.

101. The Connecticut Children's Medical Center ("CCMC"), successor corporation to the Newington Children's Hospital (formerly called the Newington Home for Crippled Children), claims an interest in the Clark Weed Trust.

102. The Clark Weed Trust (Tab 22), established under Article Third of the Will of Clark Weed, dated April 19, 1932, was created with a gift of one half of his residuary estate to Sharon Hospital, with directions "to hold the same as a trust fund in memory of my sister, Mrs. John Clark and to use the income therefrom for the general uses and purposes of the hospital." The other half of the residue of his estate passed to the Newington Home for Crippled Children. In a gift-over clause, the donor further directed "[i]n the event that at any time for any reason said Hospital should cease to exist, then I direct that said Fund be given to the Newington Home for Crippled Children."

103. According to the language of its draft Certificate of Incorporation Section 2(a) and 2(c) and Section 1.3A and 1.3C of its By-Laws, SACHF is proposed to be organized as a "supporting organization" of the BTCF under I.R.C. § 509(a)(3).

104. Article 5 of SACHF's Certificate of Incorporation provides: "The sole member of the Corporation shall be the Berkshire Taconic Community Foundation, a Connecticut non-profit corporation. The Member shall appoint all members of the Board of Directors in accordance with this Certificate of Incorporation and the Bylaws of the Corporation." Section 2.1 of the By-Laws similarly provides that the BTCF shall be the sole voting member of SACHF.

105. Article 8 of SACHF's Certificate of Incorporation provides: "This Certificate of Incorporation may be amended from time to time by a resolution adopted by two-thirds of the Board of Directors present at a meeting of the Board of Directors at which a quorum is present, and with the prior or subsequent approval of the Member; provided, however, that any amendment which materially modifies Articles 2, 5, or 10 hereof shall be first [sic] be approved by the Superior Court of _____, Connecticut."

106. Article 9 of SACHF's Certificate of Incorporation provides: "The Corporation shall have an indefinite period of existence, subject to dissolution under the laws of the State of Connecticut or by resolution adopted by two-thirds of the Directors present at a meeting of the Board of Directors at which a quorum is present and with the prior or subsequent approval of the Member."

107. Article 10 of SACHF's Certificate of Incorporation provides: "Upon the dissolution of the Corporation, the Corporation shall, after paying or making provision for the payment of all of

the liabilities of the Corporation, distribute all of the assets of the Corporation to: (a) Berkshire Taconic Community Foundation, Inc. one or more of its affiliates, or its successor thereof, as they are in good standing qualifying under Section 501(c)(3) of the Code; or (b) such organization or organizations selected by Berkshire Taconic Community Foundation, Inc. and organized and operated exclusively for charitable, educational, religious or scientific purposes as shall at the time qualify as an exempt organization or organizations under Section 501(c)(3) of the code. Any such assets not so disposed of shall be disposed of by order of the Superior Court of the judicial district in which the principal office of the Corporation is then located, exclusively for such purposes or to such organization or organizations, as said Court shall determine. "

108. Section 1.4 of SACHF's By-Laws provides for the preservation of capital: "In order to preserve the Corporation's ability to exercise its option to repurchase the assets of Sharon Hospital Inc., the following limitations are imposed on the Corporation's ability to expend or deplete its assets:

In each of years One through Five, the Corporation shall not expend or deplete more than 5% of its total assets. After year Five, there shall be no limitation, other than those imposed herein, by the Corporation's certificate of Incorporation or by any relevant statute or regulation, on the Corporation's ability to expend or deplete its assets.

For the first ten (10) years of the Corporation's existence, the Corporation's spending policies should include due consideration to the preservation of the Corporation's capital in order to preserve the Corporation's ability to exercise its repurchase option under the Purchase Agreement and the Stockholder Agreement.

109. Pursuant to Section 2.2 of SACHF's By-Laws, BTCF, as sole Member of SACHF, has the following powers over SACHF:

- a. The power to approve policies of the Corporation to assure the fulfillment of the purposes set forth in Section 1.3.
- b. The power to elect the Directors of the Corporation and to remove the Directors of the Corporation subject to Section 3.12 of these By-Laws; The power to authorize (i) the amendment and restatement of the Certificate of Incorporation and By-Laws of the Corporation; (ii) the merger or consolidation of the Corporation with any other entity; (iii) the sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all the property and assets of the Corporation; and (iv) the voluntary dissolution of the Corporation, and the plans of distribution of assets upon dissolution and the revocation of voluntary dissolution proceedings;
- c. The power to approve (i) the Corporation's strategic and business plans and (ii) any proposed change to the Corporation's mission statements;

- d. The power to approve the Corporation's (i) capital budgets, (ii) operating budgets, and (iii) non-budgeted material expenditures (classification of expenditures as "material" shall be established by the Member's Board of Directors from time to time);
- e. The power to approve the Corporation's investment policies; . . .
- f. The power to authorize the Corporation's organization or formation of a new subsidiary or joint venture entity, arrangement or relationship in which the Corporation's ownership interest will be equal to or in excess of fifty percent (50%) of the net income or voting interests therein;
- g. The power to authorize the Corporation's incurrence or guarantee of material indebtedness to any other person or entity (classification of an indebtedness as "material" shall be established by the Member's board of Directors from time to time) and a mortgage or pledge of, or grant of a security interest in, property or assets of a hospital or related entity in connection with such indebtedness;
- h. The power to approve the Corporation's human resource plans;
- i. The power to authorize any vote by the Corporation of the capital stock, membership or partnership voting rights owned by the corporation in any and all of its subsidiaries or affiliates with respect to any of the foregoing.

110. The powers of the Member of SACHF listed in Section 2.3 of the By-Laws may be exercised by a majority vote of the Members of the Board of BTCF at a duly noticed meeting, or without a meeting if a duly authorized representative of the Member signs a written consent, setting forth the action.

111. Pursuant to Article IX of SACHF's By-Laws, any alterations, amendments or repeals of SACHF's By-Laws may be made solely by the action of the Member, BTCF.

112. All proceeds of the proposed sale of Sharon Hospital Inc. to Essent CT that pass to SACHF are proposed to be held by SACHF subject to any future liability of the Seller arising from the resolution of litigation relating to a Superfund site at the Amenia Landfill located on Rte 22 South, Amenia, N.Y. (CERCLIS No. NYD-980641559, Docket 02-1999-2022-0001).

113. Further findings of fact are set forth below in the Conclusions of Law section where necessary.

V. CONCLUSIONS OF LAW

Conn. Gen. Stat. § 19a-486a *et seq.* directs that any non-profit hospital that enters into an agreement to transfer a material amount of its assets or operations with an entity operated for

profit must obtain the approval of the Commissioner of Health Care Access and the Attorney General. Any agreement made without the approval required by law is deemed void.

Connecticut General Statutes § 19a-486c mandates that the Attorney General shall disapprove a proposed sale of a nonprofit hospital to a for-profit entity as not in the public interest if he determines that one or more of the following conditions exist:

- (1) the transaction is prohibited by Connecticut statutory or common law governing nonprofit entities, trusts or charities;
- (2) the nonprofit hospital failed to exercise due diligence in (A) deciding to transfer, (B) selecting a purchaser, (C) obtaining a fairness evaluation from an independent person expert in such agreements, or (D) negotiating the terms and conditions of the transfer;
- (3) the nonprofit hospital failed to disclose any conflicts of interest, including, but not limited to, conflicts pertaining to board members, officers, key employees and experts of the hospital, the purchaser or any other party to the transaction;
- (4) the nonprofit hospital will not receive fair market value for its assets, which, for purposes of this subsection, means the most likely price that the assets would bring in a sale in a competitive and open market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably and in their best interest, and with a reasonable time allowed for exposure in the open market;
- (5) the fair market value of the assets has been manipulated by any person in a manner that causes the value of the assets to decrease;
- (6) the financing of the transaction by the nonprofit hospital will place the nonprofit hospital's assets at an unreasonable risk;
- (7) any management contract contemplated under the transaction is not for reasonable fair value;
- (8) a sum equal to the fair market value of the nonprofit hospital's assets (A) is not being transferred to one or more persons to be selected by the Superior Court who are not affiliated through corporate structure, governance or membership with either the nonprofit hospital or the purchaser and (B) is not being used for one of the following purposes: (i) For appropriate charitable health care purposes consistent with the nonprofit hospital's original purpose, (ii) for the support and promotion of health care generally in the affected community, or (iii) with respect

to any assets held by the nonprofit hospital that are subject to a use restriction imposed by a donor, for a purpose consistent with the intent of said donor; or,

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

The Conversion Act requires me to disapprove the transaction if I find that one or more of these conditions exist. The Act also authorizes me to impose modifications on the proposed transaction if I approve it. I address each of the statutory criteria separately.

A. The Proposed Transaction is Not Prohibited by Connecticut Statutory or Common Law Governing Nonprofit Entities, Trust or Charities

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(1), the Attorney General shall disapprove a proposed agreement if he determines that the transaction is prohibited by Connecticut statutory or common law governing nonprofit entities, trusts or charities. Subject to the modifications and adjustments set forth in Part VI, I conclude that the transaction is not prohibited by statutory or common law governing nonprofit entities, trusts or charities.

B. Sharon Hospital Exercised Due Diligence

1. The Hospital exercised due diligence in deciding to transfer its assets

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(2)(A), the Attorney General shall disapprove a proposed agreement if he determines that the non-profit hospital failed to exercise due diligence in deciding to transfer the assets of the hospital. This established standard incorporates a term of art in business and corporation law, very similar to the reasonableness standard discussed above.

The statutory criteria does not require me to conclude whether, as a factual matter, Sharon Hospital made optimal decisions or the best possible choices or did absolutely everything in its power to avoid selling the hospital or to avoid selling the hospital's assets to a for-profit

entity. Instead, the statute simply requires me to ascertain whether the Hospital exercised due diligence in making such choices. Although the phrase "due diligence" is not defined by the statute, it is generally defined to be a measure of "prudence, activity, or assiduity, as is properly expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case." Black's Law Dictionary (5th ed. 1979).

Thus, this inquiry focuses on the process employed by the Hospital in reaching its decisions and not on whether the Hospital made the best possible choice. The evidence in the record supports a conclusion that the Hospital engaged in a decisionmaking process that was reasonable and that its ultimate decision to transfer the assets of the Hospital, although not necessarily the only choice, demonstrated due diligence under the circumstances.

Sharon Hospital suffered substantial operational losses from 1996 to the present. From 1996 to 2000, the hospital sustained operational losses of \$1,370,342, \$703,036, \$4,538,591,^{6/} \$4,869,988, and, \$2,389,255, respectively. For its fiscal year ending September 30, 2001, the Hospital is projected to show an operating loss of \$2.73 million. These losses have threatened the Hospital's ability to provide healthcare to those within the Hospital's catchment area. The Hospital's financial situation may be attributable to many different factors, not the least of which is the economics of an ever-changing health care industry.

The Hospital, recognizing the need for assistance, engaged the health care consulting firm of Nolan & Bober Associates ("Nolan & Bober") from July, 1998 to January, 1999. As part of its engagement, Nolan & Bober analyzed the financial and operating performance of the Hospital, as well as the surrounding market and competitive forces. According to Nolan & Bober's analysis

^{6/} The 1998 operating deficit would have been even greater but for a one-time unrestricted gift of \$1.85 million applied to reduce the operating deficit.

and financial projections, the Hospital faced significant operating losses through 2003. Based on these projections, Nolan & Bober recommended that the Hospital seek some form of partnership in order to safeguard its long-term viability.

The Hospital initiated partnership discussions with other hospitals. Representatives of the Hospital met with Charlotte Hungerford, New Milford and Vassar Brothers Hospitals to discuss partnering options. These discussions proved fruitless due to differences in mission and the potential partner's own internal problems. It is worth noting that, at this critical juncture, Sharon Hospital was not a particularly appealing partner to other entities, given the seemingly insurmountable operational losses it was experiencing.

The decision to transfer the Hospital was also supported by Cambio Healthcare Solutions, LLC, the health care management consulting firm retained by Sharon Hospital on December 2, 1999, to attempt to stabilize the Hospital's financial situation. After a thorough examination of Sharon Hospital's financial condition, Cambio became convinced that the Hospital, independently, or through a loose affiliation with another entity, could not successfully address the critical issues facing it. Cambio recommended to the Board that the Hospital be sold. After deliberating, the Board decided that selling the Hospital was the only viable option if the Hospital was to remain an acute care facility. The Board instructed Cambio to assist it in commencing the Request for Proposal ("RFP") process.

Nevertheless, further discussions were also held with Albany Medical, Berkshire Health System and St. Francis Hospital in Poughkeepsie, NY. After substantive discussions with other Connecticut and New York hospitals, the Board realized that an affiliation probably could not be accomplished, nor would an affiliation likely solve the fundamental financial problems facing Sharon Hospital. The Board concluded that it needed to explore a sale of the Hospital. The

decision to sell the Hospital was made largely because no neighboring hospital would consider any relationship with Sharon Hospital requiring the expenditure of significant management time or the investment of capital.

Representatives of the Community Association to Save Sharon Hospital ("CASSH") have asserted that the Board failed to exercise due diligence in deciding to transfer the Hospital because other options were not explored prior to making the decision to transfer. In particular, CASSH argues that the Board should have retained a crisis management turnaround firm *prior* to deciding to sell the Hospital. Had the Hospital retained such a firm, CASSH argues, it is possible the Hospital's financial situation could have improved, making a sale unnecessary. In support of this claim, CASSH points to the successes that Cambio has had in bringing some degree of financial stability to the Hospital since that management company was retained to manage the Hospital **after** the Board decided to sell it.

While this argument has some merit, it fails to fully appreciate the severity of the financial crisis facing the Hospital at the time the Board heeded Nolan & Bober's recommendation to aggressively pursue partners in an effort to ensure the Hospital's long term viability. As noted above, the Hospital had operational losses of \$4.9 million and \$4.5 million in 1999 and 1998, respectively. After an exhaustive analysis of relevant data, Nolan & Bober concluded:

As inpatient utilization continued [sic] to decline, the total market (all primary and secondary service area towns) for inpatient services would not be adequate to permit Sharon Hospital to operate at a financial breakeven. . . . At current levels of activity **even after reducing operating costs**, Sharon Hospital would continue to generate a **several million-dollar deficit each year**. At projected inpatient and outpatient utilization levels, Sharon Hospital would continue to generate a deficit of several million dollars per year. . . . Additional savings could be achieved if clinical services could be shared.

Nolan & Bober, Sharon Hospital Strategic Financial Plan, Executive Summary July 1998-January 1999, p. 4 (emphasis added).

Given such dire warnings from an industry expert, coupled with the staggering operational losses the Hospital was enduring at the time, it was not unreasonable for the Board of Directors of Sharon Hospital to follow its expert's recommendation to consider transferring the Hospital's assets in order to ensure the Hospital's long term viability. Although an interim management firm might have cut operational costs through sophisticated and stable management, it is unlikely that such a firm could provide a long-term solution to the Hospital's financial difficulties, because cost-cutting would not address the Hospital's critical need for capital.

J. Alix & Associates, the independent expert I retained to review the proposed transaction, similarly concluded that the Board exercised due diligence in deciding to transfer the Hospital's assets. J. Alix & Associates based its conclusion on an exhaustive review of all available data, including minutes of Board meetings, as well as reports prepared by industry experts. J. Alix & Associates found that the Board's decision, which was reached after a long multi-step process, was reasonable given the Hospital's financial and operational problems, the bleak outlook for the future, the recommendations of several outside consultants and the minimal interest in affiliation shown by other nonprofit hospitals.

I accept and concur with the opinion of J. Alix & Associates. After reviewing its options, the Board reasonably relied on the recommendations of two industry experts that Sharon Hospital seek a partner to stabilize its financial situation and obtain capital for improvements to the physical plant. Moreover, the Board exercised due diligence in deciding to sell Sharon Hospital's assets only after its serious, good faith efforts to seek a strategic partner proved unsuccessful.

2. The Board exercised due diligence in selecting the purchaser

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(2)(B), the Attorney General shall disapprove a proposed agreement if he determines that the non-profit hospital failed to exercise due diligence in selecting the purchaser. I conclude that the Hospital exercised due diligence in selecting the purchaser.

On February 26, 2000, Sharon Hospital authorized Cambio^{7/} to develop an RFP to solicit bids from a broad range of hospitals and hospital companies. Given the Hospital's dire financial situation and the inability to structure affiliations or other arrangements with local non-profits, Cambio recommended to the Board that it would be prudent to include for-profit firms in the group of target recipients for the RFP. Although the Board strongly preferred to partner with another nonprofit hospital, it recognized the need to consider all offers in order to select the best proposal that would result in a contribution of capital and the maintenance of a high quality, full service, acute care facility in the community. Based on the recommendations of its industry experts, the Board authorized Cambio to forward copies of the RFP to both for-profit and non-profit concerns.

Some members of the community have criticized the Board's decision to include for-profit entities among those receiving the RFP. They argue that by including for-profit entities in the RFP process--and by ultimately selecting a for-profit entity as purchaser of the Hospital---the Board failed to take into consideration the community's best interest. In support of this claim, they state that a for-profit entity will necessarily reduce charity care and certain services in an

^{7/} It is worth noting that prior to engaging Cambio, the Board interviewed and considered five other firms for this assignment. Cambio was selected due to its experience in working with other similarly situated institutions and because of its expert knowledge of the health care marketplace nationally. The Board exercised due diligence in retaining Cambio for the assignment.

effort to insure profitability. They point to this possibility and others as evidence that the Board failed to exercise due diligence in including for-profit entities in the RFP process.

Our General Assembly has already addressed these concerns. It has enacted legislation expressly authorizing the sale of nonprofit hospitals to for-profit entities, Conn. Gen. Stat. 19a-486a, *et seq.* ("the Conversion Statute"), joining an ever-growing number of states that have allowed, but closely regulated, the conversion of charitable hospitals to for-profit status. States like Connecticut that have passed such laws have done so fully aware of the misgivings many consumers share regarding for-profit hospitals. In order to address these concerns, the legislature has imposed a series of regulatory requirements designed to safeguard the public interest while, at the same time, permitting such conversions to occur.

The comprehensive RFP drafted by Cambio required interested parties to provide details regarding:

- * the amount of consideration;
- * specific assets/liabilities included in the transaction;
- * treatment of contingent liabilities and pending litigation;
- * employee contracts and pension plan obligations;
- * the amount and term of any escrow;
- * the proposed strategy for Sharon Hospital post-transaction;
- * the candidate's ability to compete for managed care contracts in Sharon Hospital's primary and secondary areas and adjacent markets;
- * the degree of proposed local control and physician involvement;
- * proposed new structure or enhancement of existing structure(s);
- * the candidate's commitment to minimum capital expenditures; and,

- * how the candidate proposed to achieve efficiencies, retain, discharge, redeploy, and train employees, consolidate administrative and clinical operations, enhance, add or eliminate medical services (including details regarding minimum financial commitment to physician recruitment), and integrate with other facilities operated by the candidate.

Cambio developed a list of potential strategic partners from which to solicit proposals. Due to concerns raised by the medical staff who favored a partnership with a nearby hospital, Cambio only contacted hospitals that were in relative proximity to Sharon Hospital. In March 2000, the RFP was distributed to fifteen parties that included both for-profits and not-for-profits. Of those receiving RFP's, ten parties--five non-profit hospitals and five investor-owned hospitals--entered into confidentiality agreements with Sharon Hospital: Community Health Systems ("CHS"), Essent Healthcare, St. Francis Hospital and Medical Center of Hartford, CT ("St. Francis"), Charlotte Hungerford, New Milford Hospital, Province Healthcare, Doctors Community Healthcare, Kurron Shares of America, Health Quest Systems and Hartford Hospital.

After potential bidders reviewed the materials, only three entities submitted proposals: Essent Healthcare, CHS and Health Quest Systems, Inc., which includes Vassar Brothers Hospital (hereinafter, "Vassar Brothers"). Of the three, only Vassar Brothers is nonprofit. The three bidders gave presentations to the Board on May 12, 2000. Essent Healthcare made a second presentation on June 10, 2000.

The Hospital properly rejected the Vassar Brothers' offer as inadequate. That proposal did not include an offer of money for the acquisition of Sharon Hospital's assets, nor was there a plan for infusion of capital. Instead, Vassar Brothers proposed to provide management services to the Hospital on a contract basis while assuming control of all the assets of the Hospital. Further, the Vassar Brothers proposal contained a \$25 million dollar "break-up" fee if Sharon

Hospital attempted to pull out of the transaction. Despite the onerous terms contained in the Vassar Brothers' proposal, the Board twice approached representatives of Vassar Brothers in an attempt to develop a more acceptable partnership arrangement. The extraordinary efforts to negotiate more favorable terms from Vassar Brothers were made, in large part, because the submission from Vassar Brothers was the only proposal from a nonprofit hospital. Ultimately, these overtures were unsuccessful, and the Board reasonably rejected the Vassar Brothers proposal as unacceptable.

The Hospital initially regarded the proposal by CHS favorably. CHS proposed to purchase all the assets of all the Sharon Hospital-affiliated corporations, including land, buildings, equipment, licenses, trade names, nursing home and net working capital for \$20.8 million. Furthermore, in addition to a strong commitment to the continuation of charity care, CHS committed to invest at least \$5 million in capital improvements over the next five years and to expend \$1 million in physician recruitment.

The Board's initial favorable reaction to the CHS proposal was tempered by the fact that CHS had based its proposal solely on data provided by Sharon Hospital in its RFP documents. In fact, CHS cautioned in its submission that it would likely readjust downward its stated purchase price as it conducted additional due diligence prior to the execution of an actual agreement. Thus, the Board became concerned that CHS would ultimately reduce its offer significantly as its knowledge of Sharon Hospital's deteriorating financial condition increased.^{8/} The Board also

^{8/} As part of its due diligence, the Hospital conducted its own investigation of the three entities that submitted proposals. Its investigation of CHS revealed that CHS had recently terminated an agreement to purchase Victor Valley Community Hospital, a non-profit hospital in California. CHS unilaterally terminated that agreement after rejecting the California Attorney General's request that CHS provide at least one percent of net revenue in charity care. Furthermore, prior to terminating that agreement, CHS had reduced the purchase price by over \$15 million during the course of the negotiations. This information reasonably led the Board to be skeptical of CHS's proposal to purchase Sharon Hospital.

interpreted CHS's lack of pre-submission due diligence as indicative of CHS's lack of commitment to the transaction and the community.

Of primary concern to the Board, however, were allegations relating to its billing practices. The Board became aware that, in December 1997, CHS disclosed coding discrepancies to the Office of Inspector General of the U.S. Department of Health and Human Services (the "OIG"). As a result of an audit conducted by an independent consulting firm and reviewed by the OIG and the Department of Justice ("DOJ"), which also conducted its own investigation, CHS entered into an agreement with these federal agencies and the applicable state Medicare programs, pursuant to which it paid approximately \$31 million in settlement of these claims.

Given the inadequacy of CHS's pre-submission due diligence, coupled with the unfavorable information gathered by the Board concerning CHS's recent legal troubles, the Board became concerned about accepting CHS's proposal. Nevertheless, the Board did not rule out CHS as a possible purchaser and opted to reserve final judgment on CHS's proposal.

With regard to the Essent Healthcare proposal, Essent Healthcare proposed to purchase the assets of the Hospital, excluding the Nursing Home, for \$16.7 million. In comparing the Essent Healthcare and CHS proposals, the Board was influenced by the fact that, although Essent Healthcare's stated purchase price was lower, the CHS proposal included, but did not properly value, the Nursing Home. CHS proposed to purchase jointly the Hospital's assets and the Nursing Home for \$20.8 million, but at that time, the Board believed that Essent Healthcare's \$16.7 million proposal, plus the separate and independent sale of the Nursing Home, would yield considerably more. In fact, subsequent to the signing of the Asset Purchase Agreement between Essent CT and the Hospital, the Nursing Home was sold to United Methodist Home of Sharon,

Inc. for \$7 million. Therefore, the Essent Healthcare bid was ultimately higher than the CHS bid on a comparable basis.^{9/}

A critical component of Essent Healthcare's proposal was its commitment to make an additional \$8 million in capital investment in Sharon Hospital in the first five years of ownership. Under the proposal, if the actual amount spent on capital improvements over those five years was less than \$8 million, Essent Healthcare would pay the difference to the successor Sharon Area Community Health Foundation ("SACHF"). Essent Healthcare, through Essent CT, also committed to maintaining at least the same level of charity care currently provided by Sharon Hospital.

While considering the proposal, the Board conducted its own extensive due diligence on Essent Healthcare, its President, Hudson Connery, and its financial backers, Thoma Cressey Equity Partners. This investigation by the Hospital was coordinated by the Board and involved Hospital management, Cambio, the Hospital's attorneys, and the medical staff. The Board also considered the results of independent investigations conducted by prominent members of the community, namely the Hon. James Buckley, Mr. Ben Heller, and Mr. Zenas Block.

Some have been particularly critical of the Hospital's decision to transfer Sharon Hospital to Essent CT instead of CHS. Specifically, they question the reasonableness of the Board's decision to transfer the Hospital to Essent CT, a new company, instead of CHS, an established health care company with over 49 hospitals in 20 states.

^{9/} CHS's bid for Sharon Hospital was \$20.8 million and included the Nursing Home. Essent's bid was \$16.39 million, but did not include the Nursing Home. The Nursing Home was subsequently sold in a competitive sale for \$7 million. Thus, if the fair market value of the Nursing Home were added to the Essent bid, that bid would be \$23.39 million. This figure, on a comparable basis, is \$2.59 million **more** than CHS's bid of \$20.8 million.

The Board considered the relative past experiences of the two competing bidders in its selection. The Board was fully aware that Essent Healthcare was a new company and, additionally, that Mr. Connery's prior venture, Arcon Healthcare, Inc. ("Arcon"), had sought bankruptcy protection after only three years of operation. The Board raised its serious concerns to Mr. Connery and conducted its own due diligence regarding these issues.

The Board learned from its investigation that Arcon was designed to bring health care services to rural areas in a concept called "a hospital without beds." Mr. Connery explained to the Board that Arcon's business concept had been considered innovative by experts in the health care industry, but Arcon had been unable to compete effectively with other providers. Mr. Connery acknowledged that he may have grown the company too quickly and that Arcon had difficulty negotiating with managed care companies that did not understand its business concept. Although Arcon failed, seven of its ten centers were purchased by local hospitals and are currently operational.

The Board's initial ambivalence concerning Arcon and Mr. Connery was assuaged by Mr. Connery's successes in the health care industry. Before starting Arcon, Mr. Connery served as the Chief Operations Officer ("COO") of HealthTrust, which owned and managed more than 110 hospitals before it was purchased by HCA in 1995. During Mr. Connery's tenure at HealthTrust, the hospitals generated more than \$4 billion in annual revenues. The Board was also reassured to learn that Mr. Connery had been selected to head Essent Healthcare by Thoma Cressey--a venture capital firm known for its emphasis on quality management--after a seven-month nationwide executive search. Moreover, that firm chose Connery even though \$17 million of the \$25 million lost in the Arcon bankruptcy belonged to Thoma Cressey, along with GE Capital.

The Board and the medical staff were also impressed with the caliber of people Essent Healthcare sent to conduct due diligence at Sharon Hospital. There was strong and enthusiastic support from physicians and Hospital staff regarding the Essent Healthcare proposal, because it demonstrated a commitment to maintain the scope of Sharon's current services.

Although Essent Healthcare was a small and relatively new company, the Board became convinced that it represented the highest and best offer for Sharon Hospital. In fact, the Board came to view Essent's size as a positive attribute: Since Essent Healthcare was a small startup, the Board believed that it would focus on the Hospital more than would CHS, a large hospital management company. In light of the information it had obtained about Essent Healthcare, Hudson Connery and Thoma Cressey, and the negative information that it had received about CHS, the Board decided to enter into an Asset and Purchase Agreement with Essent CT for the sale of Sharon Hospital.

Given the higher offer made by Essent Healthcare and the outcome of the Board's due diligence review, it was not unreasonable for the Board to select Essent over CHS as the purchaser of Sharon Hospital. The subsequent sale of the Nursing Home for \$7 million--\$5 million *more* than CHS had allocated for it in its bid--is further evidence that Essent Healthcare's bid for Sharon Hospital was the highest and best offer available on a comparable basis.

Finally, after an extensive review of all pertinent data, the independent expert retained by me concluded that the Hospital exercised due diligence in selecting Essent CT as the purchaser of Sharon Hospital. J. Alix & Associates conducted a careful review of all aspects of the decision-making process surrounding the Hospital's selection of Essent CT over all other prospective buyers and concluded that the Hospital exercised due diligence in its selection of Essent CT. Particularly, J. Alix & Associates points to Essent CT's higher comparable bid price,

the comfort that the Board had with Essent CT, and Essent CT's superior commitment to the transaction as evidence that Sharon Hospital exercised due diligence in selecting Essent CT over other bidders, including CHS. Thus, I conclude that the Hospital exercised due diligence in selecting Essent CT as the purchaser of Sharon Hospital.

3. The Hospital exercised due diligence in obtaining a fairness evaluation

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

Subsequent to the selection of Essent CT as purchaser of Sharon Hospital and after negotiating the terms of a proposed Asset Purchase Agreement, the Board considered several potential firms that could render a fairness opinion to determine whether the terms of the proposed Agreement were fair to the non-profit hospital. After interviewing several potential financial advisors, the Hospital retained Merrill Lynch, a nationally recognized investment banking firm, to prepare a fairness evaluation of the Asset Purchase Agreement proposed between Sharon Hospital and Essent CT.

In order to reach its opinion as to the fairness of the Agreement to the Hospital, Merrill Lynch first performed an extensive financial analysis of the Hospital's value. Merrill Lynch used three standard methodologies to value the Hospital's assets--discounted cash flow ("DCF"),^{10/} market comparables,^{11/} and mergers & acquisitions transaction ("M&A")^{12/} analysis. All three

^{10/} The Discounted Cash Flow valuation methodology demonstrates the potential value of an entity if its financial projections are achieved.

^{11/} The Market Comparables valuation methodology demonstrates the potential freely traded value in the public marketplace based on comparable company multiples.

^{12/} The Mergers & Acquisitions Transaction Analysis demonstrates the potential value of the company based upon purchase multiples developed from recent acquisitions of comparable

analyses represent generally accepted ways of valuing an operating entity such as Sharon Hospital.^{13/}

Merrill Lynch concluded that the fair market value of the Hospital was \$9.3 to \$10.4 million dollars. In light of Essent CT's bid of \$16.39 million, Merrill Lynch concluded that the consideration to be paid by Essent CT for the Hospital's assets pursuant to the proposed Asset Purchase Agreement was more than fair to Sharon Hospital.

The valuation expert I engaged, J. Alix & Associates, conducted an independent review of Merrill Lynch's work papers and the analyses that firm applied in concluding that the proposed transaction was fair to Sharon Hospital. Further, J. Alix & Associates conducted an independent valuation of the Hospital's Assets to compare that figure with the value assigned by Merrill Lynch. After an exhaustive review of Merrill Lynch's work, as well as its own independent valuation of the Hospital's Assets, J. Alix & Associates opined that Merrill Lynch's fairness opinion regarding the terms of the proposed transaction was reasonable. Thus, I conclude the Board exercised due diligence in obtaining a fairness evaluation regarding the terms of the proposed transaction from an independent entity expert in such agreements.

4. The Board exercised due diligence in negotiating the terms of the agreement

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(2)(D), the Attorney General shall disapprove a proposed agreement if he determines that the non-profit hospital failed to exercise due diligence in negotiating the terms and conditions of the transfer. I conclude that the Hospital exercised due diligence in negotiating the terms and conditions of the transfer.

companies.

^{13/} While the use of the Market Comparables Approach could be questioned in light of the uniqueness of Sharon Hospital both geographically and as a stand-alone hospital, Merrill Lynch's use of this methodology is not unreasonable.

diligence in negotiating the terms and conditions of the transfer, subject to the modifications discussed in Part VI that I consider necessary to ensure that the interests of the Hospital and the community are fully served and the requirements of the Conversion Act are satisfied.

After selecting Essent CT as the successful bidder, the Hospital entered into a letter of intent ("LOI") with Essent while it sought to negotiate the terms of the contemplated Asset Purchase Agreement. The Board appointed a negotiating committee consisting of the Hospital's attorneys and individual board members, Cambio staff, and Ben Heller.

The Hospital's negotiating committee was able to achieve several favorable changes to the Agreement before it was executed by the parties. Most notably, the negotiating committee was able to obtain the following concessions from Essent CT prior to the execution of the sales agreement:

- a. Essent CT agreed to pay all title insurance and survey closing costs;
- b. Essent CT agreed to remove sick pay and FICA related to sick pay from the Working Capital Adjustment--a concession valued at approximately \$300,000;
- c. Essent CT agreed to pay for many of Sharon Hospital's capital expenditures that the Hospital had not been in a financial position to previously authorize;
- d. Essent CT released a 7.5 acre parcel (with a concomitant reduction in the purchase price from \$16.7 to \$16.39) in order to facilitate the sale of the assets of the Nursing Home;
- e. Thoma Cressey agreed to guarantee all of Essent CT's financial obligations under the Agreement;
- f. Provisions that would have allowed Essent CT to terminate the transaction upon the occurrence of a material adverse change in the Hospital's financial condition were revised to make it more difficult for Essent to do so;^{14/}

^{14/} The value of this concession from Essent CT cannot be overstated in light of the significant short term operational losses projected by the Hospital that could otherwise have permitted Essent CT to unilaterally terminate the agreement if those projected losses materialized or continued during the statutory review period. As previously noted above, the projected operating loss for fiscal year ended September 30, 2001 is \$2.73 million--approximately

g. Essent CT agreed to continue the Hospital's indigent and charity care policies, and to include this covenant in any subsequent sale of the Hospital; and

h. Essent CT agreed to give the resulting charitable conversion foundation (SACHF) a right to repurchase the Hospital if Essent CT decides to sell Sharon Hospital in the future.

After an exhaustive review of the numerous issues negotiated by the Board and included in the Asset Purchase Agreement, J. Alix & Associates concluded that the Board exercised reasonable due diligence in negotiating the asset purchase agreement. Based on all of this evidence, including the concessions obtained from Essent, I conclude that the Hospital and its representatives exercised reasonable due diligence in negotiating the terms of the Asset Purchase Agreement.

Notwithstanding the significant concessions obtained from Essent Healthcare by the Board, some members of the community argue that the Hospital did not exercise due diligence in negotiating the terms and conditions of the sale. These arguments, however, focus primarily on the (1) for-profit status of Essent, (2) an underlying belief that a for-profit entity is per se inimical to the interests of the community, and (3) their belief that the Hospital's Board should have concentrated its effort on seeking private philanthropy to solve the Hospital's financial woes in lieu of a sale of its assets. As noted above, the legislature has already made the public policy choice that for-profit hospitals are not necessarily contrary to the public interest, provided that any conversion to for-profit status is subjected to rigorous regulatory review.

There is no evidence in this record that the underlying terms of the transaction are fundamentally unfair or that the Hospital's negotiating process was unreasonable. CASSH, however, has raised some valid points regarding specific provisions of the proposed transaction

\$500,000 more than the previous year.

that need additional scrutiny. For example, CASSH argues that the authority of the Advisory Board of Trustees^{15/} contemplated by the Agreement is illusory. CASSH asserts that, given the express lack of accountability by Essent CT to the Advisory Board, Essent CT could completely ignore the Advisory Board's recommendations without violating the terms of the Agreement. CASSH claims that this lack of authority by the Advisory Board will give Essent CT free reign to disregard the interests of the Sharon community, including having unfettered discretion to reduce the amount of services available to the community.

Although Essent CT would not have unfettered discretion in managing the Hospital because a reduction in services is subject to regulatory review by OHCA, CASSH's assertions concerning this issue have some merit. While I recognize that Essent CT will operate Sharon Hospital as a for-profit hospital if the transaction obtains the required regulatory approvals, I am mandated by the statute to ensure that the community's interests are fully protected. I agree with CASSH that the role of the Advisory Board must be strengthened in order to ensure that Essent CT will fully consider the community's voice in how to operate the Hospital in a manner consistent with the community's interest. Furthermore, it is extremely important that the actual authority to be exercised by the Advisory Board survive Essent CT's operation of Sharon Hospital and apply with equal force to any future for-profit purchasers of the Hospital.

To that end, and pursuant to the Attorney General's statutory authority, I will impose certain modifications to the Asset Purchase Agreement in order to ensure that the proposed transaction provides for a greater role of the Advisory Board. Thus, as a condition of the

^{15/} Section of 7.7 of the Asset Purchase Agreement states: "Advisory Board of Trustees. Buyer will create an Advisory Board of Trustees comprised of community representatives and physicians on the medical staff of the Hospital. Buyer will seek input of the Advisory Board of Trustees with respect to various decisions affecting the Hospital, including but not limited to, management evaluations, monitoring of clinical quality at the Hospital and the overall strategic direction for the Hospital."

proposed transaction's approval, the Office of the Attorney General will require that the parties to the transaction agree to the modifications, set forth in Section VI, below concerning the actual authority of the contemplated Advisory Board.

C. No Board Member, Officer or Key Employee of Sharon Hospital Has A Conflict of Interest With Respect to The Proposed Transaction

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(3), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that the non-profit hospital failed to disclose any conflict of interest, including but not limited to, conflicts of interest pertaining to board members, officers, key employees and experts of the hospital, the purchaser or any other party to the transaction. I conclude that no conflicts of interest exist that would require disapproval of the proposed transaction.

To investigate potential conflicts, I required, by way of written interrogatories, all board members, officers and key employees of Sharon Hospital to disclose any potential conflicts that they might have relating to the proposed transaction or any of the parties thereto. The disclosure forms required the respondent to state, under pains and penalty of false statement, whether:

- a. The individual, or any party related to him/her, owned stock, or options to purchase stock in Essent CT or its parent company;
- b. The individual, or any party related to him/her, was compensated as an employee or consultant of Essent CT or its parent company;
- c. The individual, or any party related to him/her, received any payment, or other financial benefit as a result of the proposed transaction;
- d. The individual, or any party related to him/her, will receive any payment, or other financial benefit as a result of the proposed transaction;
- e. The individual, or any party related to him/her, has been offered a position as a director or trustee of Essent CT or its parent company;
- f. The individual, or any party related to him/her, has been offered a consulting position or employment with Essent CT or its parent company;

g. The individual, or any party related to him/her, since January 1, 1995, has engaged in any of the following transactions with Essent CT or its parent company:

- (1) Sold or transferred assets to or purchased assets from or exchanged assets with Essent CT or its parent company;
- (2) Leased assets to or leased assets from Essent CT or its parent company;
- (3) Been indebted to Essent CT or its parent company;
- (4) Allowed Essent CT or its parent company to be indebted to you;
- (5) Furnished goods, services or facilities to Essent CT or its parent company; and,
- (6) Acquired goods, services or facilities from Essent CT or its parent company.

If any of the foregoing questions were answered with anything other than an unqualified "No," the respondent was required to attach an explanation to the response.

The respondents were also asked to describe and explain in detail how they arrived at certain decisions that could have been driven by actual or possible conflicts of interest. For instance, the respondents were asked to describe their decision-making relative to (a) partnering options available to Sharon Hospital other than the proposed sale to Essent CT or Essent Healthcare, (b) the decision as to which health care providers would receive the RFP from Sharon Hospital and, (c) whether physician incentives were discussed with Essent CT or Essent Healthcare.

Further, the individuals were asked to reveal whether they, or any related party, had any affiliation with Berkshire Taconic Community Foundation. Lastly, they were asked to reveal any agreements with Sharon Hospital, Essent CT or its parent company regarding any termination of employment or compensation agreements relating to the proposed change of control.

Every individual to whom a conflict of interest form was sent submitted a properly executed response under oath. After a careful review of all the sworn responses, there do not

appear to exist any conflicts of interest relating to the proposed transaction among Board members, officers, key employees and experts retained by Sharon Hospital or any other party to the proposed transaction. No intervenor or other participant in the proceeding has offered any credible evidence that any conflict existed at any time during the negotiation of the proposed agreement. Finally, J. Alix & Associates, the Attorney General's independent expert, concluded that there was no evidence of any conflicts. Accordingly, I conclude that no conflicts existed that would require disapproval of the proposed transaction.

D. Sharon Hospital Will Receive Fair Market Value For Its Assets

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(4), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that the non-profit hospital will not receive fair market value for its assets. For purposes of the statutory provision, "*fair market value*" is defined as "the most likely price that the Hospital's assets would bring in a sale in a competitive and open market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably and in their own best interest, and with a reasonable time being allowed for exposure in the open market." Conn. Gen. Stat. § 19a-486c(a)(4). I conclude that the nonprofit hospital will receive fair market value for its assets.

As previously noted, the proposed transaction requires Essent CT to pay \$16.39 million as a purchase price for the Hospital's assets. Two different experts, Merrill Lynch and J. Alix & Associates, have each performed an analysis of the value of the Hospital and whether the proposed purchase price represents fair market value for the Hospital's assets. Both entities have concluded that \$16.39 million is consistent with the fair market value of the Hospital, or possibly is even somewhat higher than the fair market value.

Merrill Lynch used three standard methodologies to value the Hospital's assets: discounted cash flow, market comparables, and merger and acquisitions transaction analysis. All three methodologies represent different ways to arrive at the "enterprise value" of an operating business. This is a standard way to render a fairness opinion in connection with the sale of an operating business. Based on its extensive financial analysis of Sharon Hospital and its assets, Merrill Lynch concluded that the fair market value of the Hospital was \$9.3 to \$10.4 million dollars.

J. Alix & Associates, Inc., the independent expert I retained, also reached a similar conclusion. After an exhaustive review of all available financial data, as well as a tour of Sharon Hospital's physical plant and extensive interviews with Hospital board members and other individuals, J. Alix & Associates issued a report concluding that the fair market enterprise value of the Hospital is within the range of \$10 to \$13 million dollars. Comparing the value ranges established by Merrill Lynch and J. Alix & Associates with the purchase price of \$16.39 million that Essent CT will pay for the Hospital and its assets, J. Alix & Associates definitively concluded that Sharon Hospital was receiving fair market value for its assets.

No party or intervenor has raised any credible or significant challenge to the valuation of the Hospital performed either by Merrill Lynch or J. Alix & Associates. No intervenor offered the expert testimony of any valuation expert, accountant or other financial expert to contradict the fair market value opinion offered by J. Alix & Associates.

Finally, and significantly, the fair market values assigned to Sharon Hospital and its assets by its own expert and J. Alix & Associates fall significantly below the \$16.39 million that Essent CT will pay for the Hospital and its assets pursuant to the Asset Purchase Agreement. In a sense, Essent CT's agreement to pay that amount is the best evidence of the Hospital's fair market value,

because Essent CT is a willing buyer who is offering to purchase the Hospital from a willing seller in an open competitive market. No party or intervenor has offered any evidence that undermines or seriously challenges a conclusion that \$16.39 million represents fair market value for the purchased assets.

The valuations by these experts confirm that the RFP process conducted by Cambio and the Hospital achieved a competitive sale, producing fair market value for its assets.

E. The Fair Market Value of the Hospital's Assets Has Not Been Manipulated

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(5), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that the fair market value of the non-profit hospital's assets has been manipulated by any person in a manner that causes the value of the assets to decrease. During the course of my review of the proposed transaction, some concerns have been raised regarding certain actions taken by the Hospital or others that could be interpreted as a manipulation of the fair market value of the Hospital's assets. Specifically, questions have been raised about the Hospital's retention of Cambio and a bill amnesty discount instituted by that firm shortly after its engagement.

Certain of Cambio's employees had previous professional affiliations with Essent Healthcare and/or its officers, leading to criticism of the Board's engagement of Cambio immediately prior to the Hospital's selection of Essent CT as purchaser. This allegation necessarily assumes that Cambio was somehow acting as an agent for Essent Healthcare and manipulated the value of the Hospital's assets to Essent's financial advantage. I investigated these issues, and I also asked my expert to determine whether the price to be paid for the Hospital has been adversely affected by the Hospital's retention of Cambio.

On or about October 2000, Ms. Joan Phillips, a Vice President of Cambio, was named Interim CEO of Sharon Hospital under an agreement between Sharon Hospital and Cambio. Before joining Cambio, Ms. Phillips served as CEO of Crossroads Regional Hospital. After that hospital was sold to Essent Healthcare, Ms. Phillips continued to serve as its interim CEO for approximately three months during the transition period.

Ms. Barbara Groux, Vice President of Finance of Cambio, worked for a company named HealthTrust from 1990 through 1995, while Mr. Hudson Connery, Essent CT's CEO, was Chief Operating Officer of HealthTrust. There is no evidence of a direct reporting relationship between Ms. Groux and Mr. Connery. Moreover, during that same period, Mr. Richard Salerno, Senior Vice President of Operations for Essent CT's parent company, was the CEO of two hospitals owned and operated by HealthTrust.^{16/}

After a careful review of all available evidence, I believe that the prior professional relationships between Cambio and Essent Healthcare employees did not prejudice the process and there was no manipulation of the fair market value of the Hospital's assets in favor of Essent CT or Essent Healthcare. In fact, as will be more fully described below, a review of the relevant financial data reveals that Cambio's engagement resulted in an increase of the fair market value of Sharon Hospital.

Cambio is a health care consulting firm. In addition to assisting the Board in seeking strategic partnering, Cambio was engaged by the Board to fill a critical void in executive management and to stop the rapid deterioration of the Hospital's financial condition. Cambio

^{16/} The community of health care business advisors is a small one. There are frequently professional relationships or overlapping tenures at large firms. That observation alone, however, does not foreclose my inquiry into whether Sharon Hospital's assets were indeed manipulated by Cambio due to the limited professional overlap by some of its employees with Essent Healthcare or its representatives.

brought in a team, such as Ms. Phillips and Ms. Groux, to do an immediate fiscal assessment of the Hospital. Cambio reported to the Board that it desperately needed to raise capital and improve its bottom line, which entailed instituting drastic management and operational changes. After obtaining approval from the Board, Cambio embarked on a hospital-wide assessment aimed at lowering the Hospital's operational costs. Cambio's management and operational changes stabilized the Hospital's financial condition. One way that Cambio sought to improve the Hospital's finances was to raise much needed capital. In order to meet this goal, Cambio's team proposed a 25% bill amnesty discount program. This one-time offer allowed **self-pay patients only** to deduct 25% from their outstanding bills if they immediately paid in full the remaining amount. In the months prior to this discount program, the Hospital's accounts receivable department had fallen significantly behind in billing and collections. The discount was offered in order to convert accounts receivable that might otherwise have been written off into cash.

In light of the Hospital's dire financial situation at the time the bill amnesty program was instituted, the program was reasonable action that was successful in increasing the Hospital's cash flow. Moreover, since the primary objective of the amnesty discount program was to convert uncollectible accounts into cash, the results of the program helped to increase the fair market value of the Hospital by increasing the working capital adjustment set forth in the Asset Purchase Agreement in the Hospital's favor. Thus, the effect of the one-time, thirty day 25% amnesty discount program was to enhance, not diminish, the fair market value of the Hospital's assets.

J. Alix & Associates conducted a review of all available financial data to determine whether the value of the Hospital's assets had been manipulated. After an exhaustive review of all data and the services provided by Cambio, including the decision to institute the amnesty discount

program, J. Alix & Associates concluded in its report to me that there was not a material manipulation of the Hospital's assets.

Finally, as previously discussed, the fair market value assigned to the assets of Sharon Hospital by the Hospital's own expert and the Attorney General's independent expert falls significantly below the \$16.39 million that Essent CT will pay pursuant to the Asset Purchase Agreement. Moreover, a comparison of competing bids, such as the CHS bid, confirms that the bid by Essent CT represented the highest offer for Sharon Hospital. Based on these factors, I conclude that the fair market value of the Hospital assets has not been manipulated.

F. The Financing of The Transaction Will Not Place the Hospital's Assets at an Unreasonable Risk

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(6), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that the financing of the transaction by the non-profit hospital will place the non-profit hospital's assets at an unreasonable risk. Contingent upon the modifications set forth in Section VI, I conclude that the financing of this transaction, as proposed, will not place the Hospital's assets at risk.

The precise meaning of this criterion is not apparent from its literal language. The language of this criterion appears, at first glance, to focus on the "financing of the transaction **by the nonprofit hospital . . .**" (Emphasis added). In transactions such as the present one, however, the non-profit hospital is usually not financing the transaction in any way, but is simply receiving a purchase price for its assets. That money, or some portion thereof, is then transferred to the resulting charitable conversion foundation. In addition, the language of the statute appears on its face to focus on the risk posed by the financing to the **nonprofit hospital's assets**. At the conclusion of the transaction, however, those assets will either be converted to cash, transferred to the conversion foundation, or owned by the for-profit entity that is the purchaser.

Thus, I conclude that this statutory criterion, although somewhat cryptically phrased, requires me in the context of this transaction to examine the proposed financing of the transaction to ensure that the proposed agreement does not burden the **for-profit entity** with so much debt that the transferred assets of the former non-profit hospital, albeit now operated for profit, will be placed at an unreasonable financial risk of closure or bankruptcy -- an event that would result in a loss of healthcare for the affected community.

Essent CT and Essent Healthcare are backed financially by Thoma Cressey, an established private equity firm located in Chicago, Illinois. Thoma Cressey, through its Fund VI, a \$450 million private equity fund, has agreed to commit at least \$50 million in equity capital to Essent Healthcare. Although not all of that capital is earmarked for Sharon Hospital,^{17/} Thoma Cressey, as a signatory to the Asset Purchase Agreement, guarantees all of Essent CT's financial obligations thereunder, including the commitment to invest \$8 million in capital improvements in Sharon Hospital over the next five years. Thus, in light of the financial guarantees by Thoma Cressey, the Hospital's financial position will be dramatically improved after the proposed transaction is consummated.

Furthermore, while Essent CT initially intended to finance the \$16.39 million purchase price through a combination of equity and debt financing, Essent CT has recently opted to finance the transaction entirely with equity. Mr. Connery indicated, in a memorandum dated August 3, 2001, that due to Sharon Hospital's continuing and projected losses for fiscal year 2001, Essent CT felt that the Hospital would be "strengthened" by using 100% equity financing for the initial purchase. Mr. Connery represented in that memorandum that the only debt financing anticipated would be to finance either the purchase of equipment or any post-transaction working capital,

^{17/} Essent Healthcare currently operates a hospital in Missouri and has recently purchased Hale Hospital in Haverhill, MA.

which would entail drawing on Essent's existing revolving line of credit with Heller Healthcare Finance, Inc.

This intention is evidenced by a Resolution executed by Essent Healthcare's Board of Directors on or about August 28, 2001 which states, in pertinent part:

RESOLVED, that in connection with the closing of the transaction contemplated by the Asset Purchase Agreement dated as of October 14, 2000, as amended, by and among [Sharon Hospital] . . . and . . . [Essent], the Board hereby authorizes and directs the officers of [Essent] . . . to take all necessary steps to utilize equity funds obtained under the provisions of the Purchase Agreement dated as of March 19, 1999 among [Essent], Thoma Cressey Fund VI, L.P., Thoma Cressey Friends Fund VI, L.P. and Bryan C. Cressey in funding all of the Purchase Price (as defined in the Asset Purchase Agreement), other than the portion of the Purchase Price allocated to Adjusted Working Capital (as defined in the Asset Purchase Agreement); and, FURTHER RESOLVED, that the officers of [Essent] are. . . hereby authorized and empowered to utilize the accounts receivable financing arrangement represented by the Loan and Security Agreement dated . . . April 17, 2000 with Heller Healthcare Finance, Inc., in order to fund the portion of the Purchase Price represented by the Adjusted Working Capital;. . .

Essent Healthcare, Inc. Action Taken on Written Consent by the Board of Directors, August 28, 2001.

Pursuant to that resolution, Essent CT agrees that it will use equity to fund all of the purchase price, other than the portion of the purchase price allocated to Adjusted Working Capital. In order to hold Essent CT to this commitment, approval of this application will be made contingent on the fulfillment of this representation. *See* Section VI. Because most of the purchase price of \$16.39 million will be paid with funds not secured by any of the Hospital's assets, I conclude that the proposed financing of the transaction will not place the Hospital's assets at an unreasonable risk.^{18/}

^{18/} J. Alix & Associates also opined that the financing of the transaction did not place Sharon Hospital's assets at an unreasonable risk. J. Alix & Associates conducted an exhaustive review of the capital structure of the proposed transaction, including all agreements by and between Essent CT, its parent company and its capital sources. J. Alix & Associates concluded in its report to the Attorney General that it appeared that the amount of leverage in

There is, however, one aspect of Essent CT's financial proposal that may pose an unreasonable risk to the Hospital's assets. Essent Healthcare, Essent CT's parent company, has a \$10 million revolving credit line with Heller Financial Services, Inc. This credit line will not be used to finance the purchase of the Hospital, but it will be used to pay approximately half of Essent CT's commitment to invest an additional \$8 million in Sharon Hospital over the next five years. Significantly, Essent Healthcare may also draw on this line of credit to generate capital for projects **unrelated to Sharon Hospital**.

The line of credit from Heller is to be secured by Sharon Hospital's accounts receivable, along with the accounts receivable from other hospitals owned now or in the future by Essent Healthcare.^{19/} If the present transaction is approved, Heller will obtain a continuing first priority lien on and security interest in, among other things, all of Essent Healthcare's existing and hereafter acquired accounts receivable, including those belonging to Sharon Hospital.

Although I recognize that this type of financing may be common, I am concerned that a sizable part of the Hospital's accounts receivable, a significant Hospital asset, may be used to secure other ventures of Essent Healthcare totally unrelated to Sharon Hospital. Unless modified to restrict the use of Sharon Hospital's accounts receivable to secure only debt incurred for the improvement of Sharon Hospital and its services, this type of financial arrangement places the

the anticipated capital structure of the Hospital post-transaction would not place the Hospital's assets at an unreasonable risk. In fact, J. Alix & Associates opined that the anticipated capital structure of the Hospital fell within that generally found in the hospital industry. J. Alix & Associates therefore concluded that the proposed financing of the transaction did not place the Hospital's assets at "an unreasonable risk."

^{19/} This type of financing arrangement appears to be conventional in the health care industry and serves to ensure steady access to working capital, given the average age of typical accounts receivable.

Hospital's assets at an unreasonable financial risk if Essent Healthcare suffers financial difficulties at one of its hospitals other than Sharon Hospital.^{20/}

Thus, as a condition of the proposed transaction's approval, I require that Essent CT agree to the modifications regarding any cross-collateralization of the Hospital's assets, as more fully set forth in Section VI.

G. All Management Contracts Under the Transaction Are For Reasonable Fair Value

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(7), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that any management contract contemplated under the transaction is not for reasonable fair value. No management contracts are included in the Asset Purchase Agreement. Essent CT has represented that it will manage the facility with current employees or that it will conduct a search for candidates for senior management after the close of the proposed transaction. J. Alix & Associates stated in its report to me that no management contracts for the future management of the Hospital by an outside management company were disclosed as part of its review of the proposed transaction. Because there are no executed management contracts, and none are contemplated, a determination that management contracts are for reasonable fair value is not necessary.

H. Assuming compliance with the modifications imposed below, a sum equal to the fair market value of the non-profit hospital's assets will transfer to an appropriate charitable conversion foundation

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

^{20/} Essent CT asserts that this condition should not be imposed because it will require it "to maintain and administer two separate loan agreements with Heller, thereby increasing its administrative overhead and costs." In response to questions posed by me at oral argument, Essent CT could not articulate the amount of these costs. Even if it had provided such information, I conclude that any additional costs to Essent CT are justified by the significant risks to the Hospital's assets posed by the cross-collateralization of its assets.

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

Thus, the language of Conn. Gen. Stat. § 19a-486c(a)(8) requires the Attorney General to review whether a "sum equal to the fair market value of the nonprofit hospital's assets" is being transferred to an independent entity dedicated exclusively for healthcare purposes in the affected community. This criterion first requires me to set a fair market value for assets of the nonprofit hospital to be purchased and then to review the proposed agreement to ensure that the required amount of money will be transferred to the resulting conversion foundation.

1. The fair market value of the Hospital

As discussed at some length above, I received three primary pieces of evidence regarding the fair market value of the Hospital. First, Merrill Lynch, which was retained by the Hospital to conduct the fairness evaluation of the proposed transaction, concluded that the fair market value of the Hospital was between \$9.3 and 10.4 million. Second, J. Alix & Associates valued the Hospital at \$11 to 13 million. Finally, Essent CT agreed to purchase the Hospital for \$16.39 million (plus 1,000 shares of Essent's Class B stock).

Each of these figures represents a sum that does not include the value of the Hospital's charitable assets and endowment. These valuation numbers are intended to capture the fair market value of the Hospital as an on-going, for-profit enterprise, which, of course, would not have access to the charitable assets of the non-profit hospital. Thus, under the structure of the Asset Purchase Agreement and in the valuation analysis of the experts, the charitable funds were assumed to be passed to the conversion foundation separately.

Moreover, these valuation figures do not account for the fact that the Hospital's assets are significantly encumbered by the Hospital's liabilities that must be paid or provided for at the closing, including, but not limited to, the Hospital's obligation to pay Fleet Bank roughly \$12 million to retire its line of credit. In fact, the fair market value of the Hospital, at least as that term is used in the statute, cannot mean simply the fair market value of the Hospital, but instead represents that value minus the Hospital's debt and other liabilities. Consequently, I conclude, under the circumstances and structure of this particular transaction, that the statute requires that the conversion foundation receive the Hospital's charitable trusts and gifts (all of which are excluded from the Asset Purchase Agreement) plus the net proceeds from the sale.

The evidence in the record submitted by Essent CT and the Hospital provides that the net proceeds is estimated to be approximately \$2,308,845 at the time of closing. However, in light of the manner in which the parties have structured the Asset Purchase Agreement, including the definition of Adjusted Working Capital, this number is subject to continuing change until the date of the closing. In fact after the record in this case formally closed on August 30, 2001, the Hospital and Essent CT served on me a copy of its Certificate of Need application ("CON"), recently filed with the Commissioner of OCHA, that contains substantially different projections as to the amount of net proceeds from the sale. Footnote 4 to the Sources and Uses of Transactions

Proceeds Table contained in the Application for the CON expressly recognizes that the change in the amount of net proceeds resulted from previous errors or misstatements regarding the Hospital's finances. Moreover, throughout this proceeding, the Hospital has regularly submitted various financial projections and accounting spreadsheets that contain significant and troubling errors.

Essent CT's Certificate of Need application states that the amount of net proceeds that are proposed to be transferred to the conversion foundation at the closing if all regulatory approvals have been obtained is only \$1,974 (as of August 31, 2001), compared with parties' earlier calculations, submitted less than two months prior, of \$2,308,845. The discrepancy between the projections highlights the difficulty of applying the statutory criterion imposed by the legislature--that a sum equal to the fair market value of the Hospital's assets be transferred to the conversion foundation. The difficulty arises from the particular structure chosen by the parties for this transaction, which allows for continuing and material change in the calculation of net proceeds. Indeed, even if the numbers contained in the CON application were formally a part of this record and were subsequently found to be accurate, those figures could substantially change again before the yet determined closing date for the transaction. The Conversion Act makes no explicit provision for the sort of varying, evolving, often unreliable data involved here.

Accordingly, in order to ensure that the purchase price is not improperly manipulated in the interim and to guarantee compliance with the statutory requirement that a sum equal to the fair market value of the Hospital's assets is transferred to the conversion foundation, I impose as a condition of approval that the Hospital and Essent CT submit, at the time of the closing, to a review by an independent forensic accountant, chosen by the Attorney General, in order to ensure that all money required to be transferred to the conversion foundation pursuant to the Asset

Purchase Agreement and the Conversion Act is in fact transferred. The cost for the services of this independent forensic accountant shall be borne by Essent CT.

Sharon Hospital and Essent CT shall make available to the forensic accountant any information he deems necessary to conduct this review. Within three weeks after the date of the closing, the forensic accountant shall report to the Attorney General and the parties the amount of net proceeds to be transferred to the proposed conversion foundation based upon his calculation using the Adjusted Working Capital formula contained in the Asset Purchase Agreement. Essent CT and the Hospital must agree to be bound by any changes made by the forensic accountant to the amount of net proceeds to be transferred. (If they do not agree, the sale shall be deemed disapproved.) The parties, within one week of issuance of the report of the forensic auditor, shall adjust the final closing figures in accordance with his report.

2. Description and quantification of the Hospital's Charitable Assets to be transferred to the conversion foundation

The next step of the analysis requires me to describe and quantify the charitable assets of the Hospital that will be available to transfer to the resulting charitable conversion foundation.

(a). Purpose of Attorney General's Review of Charitable Gifts

A full analysis and review of the Hospital's charitable gifts and trusts at this time is essential for several reasons. First, it permits me to fulfill my statutory obligation to ensure that the conversion foundation receives all of the Hospital's charitable gifts and trusts to which it is entitled under the statute. Second, this review ensures that the Hospital's analysis and treatment of charitable funds in the proposal correctly interprets the donors' charitable use restrictions so that the donations may pass to the foundation subject to any "use restriction imposed by a donor, [and] for a purpose consistent with the intent of said donor." Conn. Gen. Stat.

§ 19a-486c(a)(8)(B)(iii). Third, it ensures that, with respect to the charitable gifts, no aspect of the transaction is "prohibited by Connecticut statutory or common law governing nonprofit entities, trusts or charities." Conn. Gen. Stat. § 19a-486c(a)(1). Finally, it provides the proposed conversion foundation with accurate information about whether the gifts are restricted under Connecticut law, the value of the principal of each endowment, the value of realized and unrealized appreciation, the value of any accumulated interest relating to restricted endowments, and the correct value for the unrestricted funds. Only with this profile will the conversion foundation have sufficient information to administer the resulting funds in accordance with donor restrictions, charities law, the terms of the contractual agreements, and any modifications that I might require.

(b). Documents Reviewed and Legal Standards

As part of the Notice and Application, I requested, and Sharon Hospital has provided, a review and analysis of its charitable gifts and endowments. The Hospital was required to provide copies of the gift instruments, (including wills, inter-vivos trust agreements, and documentation of inter-vivos gifts) documenting the original amount received^{21/} and the donor's restrictions or directives reflecting how the gift was to be used by the Hospital. The purpose of my request was to obtain the information necessary to: (1) review the full gift instrument for each of the Hospital's gifts to determine whether its language would permit a gift to pass to the foundation, or whether a

^{21/} Not all the funds involved in the transaction are "institutional funds" within the definition set out in Conn. Gen. Stat. § 45a-527(2) of the Connecticut Uniform Management of Institutional Funds Act. Because so many fit that category, however, I asked the Hospital to apply the definition of "historic dollar value" set out in Conn. Gen. Stat. § 45a-527(5) uniformly as a standard to define the "original value" of the gift to all charitable funds held by the Hospital. This definition is particularly helpful when several intervivos or testamentary gifts pour into a particular memorial fund from numerous family members or wills to form the principal of the fund. In the review, I requested the value of the principal of funds held by outside banks or trustees.

reverter clause or gift-over provision would be triggered by the proposed conversion that would require the donation to revert to the donor's heirs-at-law or pass to another charity selected by the donor or the trustee; (2) determine the initial value of the donation in the case of fully expendable funds [or of principal in the case of endowment funds] so as to permit me to allocate properly any accumulated appreciation and income among the gifts in pooled funds, if the Hospital held them in pooled investments rather than individual accounts; and (3) determine whether the donor restricted the use of a fully expendable gift, or the income earned on an endowment fund, to a particular charitable purpose set out in the gift instrument, such as free beds, charity care, maintenance, a building fund, or research.

(c). Amount Stated by Hospital in Application

The Hospital states, in its original Application and in certain subsequent documentary submissions, that the Hospital would transfer approximately \$13,237,624 in Charitable Assets, plus an additional \$8,565,212 in Endowment funds, to the conversion foundation. Thus, according to its calculation, a total of \$21,802,836 would be "available to be transferred to SACHF." On August 14, 2001, the Hospital updated these figures and states that the "amount available" to the SACHF would be \$23,485,785. The \$23,485,785 includes: net sale transaction proceeds of \$2,308,845, a Total of Other Charitable Assets of \$12,510,352, and a Total Endowment of \$8,666,588 (broken down into Amounts Held in Trust by Others of \$6,501,116 and Restricted Net Assets of \$2,165,472).^{22/} August 14, 2001 was the first day of the Attorney General's two days of evidentiary hearings. All figures and projections submitted by the Hospital and by Essent up to and including August 14, 2001 were subject to review by the Attorney

^{22/} The Hospital's Sources and Uses Chart assigns no value to the proceeds of the sale of the Nursing Home and does not account for the use of the \$121,976 being held by the Sharon Hospital Auxiliary. These issues are discussed at length herein.

General's expert for manipulation, as required by the Conversion Act. Consequently, this decision is based upon figures provided as of August 14, 2001.

(d). Hospital's Charitable Gifts and Trusts including an analysis of their original Values

The first step of this review requires me to list and describe each of the charitable trusts and gifts benefiting Sharon Hospital. This information has been obtained from the Hospital's submission of evidence documenting 194 charitable gifts. Of these, the Hospital classified three as restricted endowments with a total principal of \$277,324^{23/} and no accumulated interest. Eighteen were classified as unrestricted endowment funds with a total principal^{24/} of \$1,054,129^{25/} and no accumulated interest. Sixteen were classified as non-endowment restricted charitable gifts, which, according to my analysis, total \$2,186,564 and have been fully expended. The Hospital classified the remaining 151 as unrestricted gifts with a total historic dollar value of \$8,904,634.^{26/} The Hospital's submissions reflect that the total value of unrestricted gifts, including accumulated interest of \$3,333,976, totals \$11,505,559 as of May 31, 2001.^{27/}

^{23/} This amount is also the historic dollar value of the restricted endowments.

^{24/} This amount is also the historic dollar value of the unrestricted endowments.

^{25/} A \$10,000 unrestricted gift from the Nelson Slater estate was received by the Hospital on August 1, 2001, after the last update to the Funds Value Report, and is therefore not included in this figure or elsewhere in the chart.

^{26/} This number includes the Harriette Harrison gift, which the Hospital treats as unrestricted and I treat as restricted.

^{27/} Missing from the records of the Hospital, and consequently from the Gift Analysis, was documentation of the language of an estimated eight gifts totaling approximately \$25,356.69 including those from: Everitte St. John, Henry S. Chapman, David Lloyd, Louis E. Schwab, Donaldson Brown, Settie Hirsch, and Emily Whitney. The Hospital's numbers were silent on the issue or how these gifts were accounted for and the \$25,356.69 is not included in the Funds Value Report or any accounting or reckoning. These funds are accounted for in my analysis set forth below.

The information concerning the Hospital's charitable gifts, endowments, and interests in gifts held by outside banks or trustees, has been carefully examined by reviewing the full text of all wills, trusts and other gift instruments, all judgments affecting particular gifts, and by calculating the historic dollar value of each gift, trust or fund. Attached to this decision as Exhibit A is a table setting forth how I have categorized the individual gift instruments.^{28/}

I must first determine the correct amount of the value of the Hospital's unrestricted and restricted charitable gifts. The Hospital's numbers appear to reflect that the "historic dollar value" of all unrestricted charitable gifts was \$8,904,634.^{29/} It reported the historic dollar value of its restricted endowment funds (free beds) as \$277,324 and the historic dollar value of the principal of its unrestricted endowment funds as \$1,054,129.^{30/} The Hospital reported the current value of its unrestricted gifts as \$11,505,559, including \$3,333,976 in accumulated income earned by these funds. The Hospital assigned a value of \$2,186,564 to restricted use gifts that, it states, have been fully expended.

Based upon my legal analysis, I make the following corrections and adjustments to the Hospital's analysis of its charitable funds. As the first step in this process, the value of restricted endowment funds (free beds) held by the Hospital should be adjusted upwards to a historic dollar value of \$299,699 to reflect the inclusion of the \$22,375 in proceeds from the Harriette Harrison estate as a free bed fund, as the donor intended. The historic dollar value of the principal of unrestricted endowment funds held by the Hospital should also be adjusted upwards to

^{28/} After a thorough review of the original gift instruments, the Attorney General's calculations reflect \$270 more in donations than the Hospital's analysis reflects.

^{29/} This figure includes the gift of Harriet Harrison as a free bed fund.

^{30/} This figure does not include the \$10,000 principal from the Slater estate to be added to the unrestricted endowment, which had not been transferred to the Hospital as of May 31, 2001.

\$1,064,129 to reflect the receipt of the \$10,000 in endowment principal from the Nelson Slater estate. The application did not account for \$25,357 in unrestricted charitable funds to account for certain gifts for which wills or other gift instruments have been lost, or never located by counsel in the process of the review of charitable gifts and endowments. Based upon the Hospital's representations and the age of the gifts, I conclude they are fully expended.

With the initial adjustment, my calculations reflect that the sum of the total charitable funds reported by the Hospital as of May 31, 2001 should be \$12,869,387.

(e). Certain Gifts Should Have Been Treated As Restricted.

The next step in the analysis requires proper classification of all of the charitable gifts and trusts in order to ensure that the donor's intent is followed. The Statute of Charitable Trusts provides in relevant part: "Any charitable trust or use . . . shall forever remain to the uses and purposes to which it has been granted according to the true intent and meaning of the grantor and to no other use." Conn. Gen. Stat. § 45a-514. Similarly, the Statute of Charitable Uses provides in relevant part: "All estates granted for . . . any public and charitable use, shall forever remain to the uses to which they were granted, according to the true intent and meaning of the grantor, and to no other use whatever." Conn. Gen. Stat. § 47-2.

The meaning of these statutes is clear. "Where property is given to a charitable corporation and it is directed by the terms of the gift to devote the property to a particular one of its purposes, it is under a duty, enforceable at the suit of the Attorney General, to devote the property to that purpose." (Emphasis added.) 2 Restatement (Second), Trusts § 348, comment (f), p. 212 (1959), *cited in Carl J. Herzog Foundation, Inc. v. University of Bridgeport*, 243 Conn. 1, 5 (1997). "The theory underlying the power of the Attorney General to enforce gifts for

a stated purpose is that a donor who attaches conditions to his gift has a right to have his intention enforced." Herzog, *supra* at 7.

I find that the donors of the following gifts expressed an intent to restrict the use of the following funds to a particular purpose within the charter of the Hospital. The Hospital's categorization of them at points in this case as unrestricted was legally incorrect. Therefore, I am providing the comments below to clarify my analysis of these funds. As previously noted, most of the gifts set out below were reported by the Hospital as fully expended, but, in most cases, no documentation of any specific use or transfer was provided.^{31/}

Belcher, Benjamin M. (Tab 35) This is a series of inter-vivos gifts from 1976 through 1985. In 1978, the donor requested that the funds be applied to capital improvements; in 1979 he restricted the use to "capital expenditures." The Hospital incorrectly treats the donations as unrestricted. In a supplemental production dated August 3, 2001, the gifts are reported as being fully expended.

DeMusey, Rosa (Tab 59) This is a gift given to be used "for a free bed for the poor." The Hospital incorrectly treats it as unrestricted. In a supplemental production, dated August 3, 2001, the gift is reported as being fully expended.

Eberle, Katharine (Tab 63) This is a gift of a portion of the residuary estate to "defray expenses incurred by the hospital in caring for patients unable to pay charges for their care." The Hospital incorrectly treats this free bed gift as unrestricted. In a supplemental production, dated August 3, 2001, the gift is reported as being fully expended.

Elting, Marjorie (Tab 66) This is a gift of \$60,972 of stock intended for "the Restricted Plant and Improvement Fund." The Hospital incorrectly treats it as unrestricted. In a supplemental production, dated August 3, 2001, the gift is reported as being fully expended.

Falls, Bedelia Croly (Tab 68) This is a trust held by the Trust Company of the Berkshires and Attorney Mark Capecelatro as cotrustees. Forty percent of the net income is paid out to the Hospital to "be expended for the payment of hospital bills of indigent patients." The Hospital incorrectly treats this stream of income, which is intended to provide a free bed, as unrestricted.

^{31/} With respect to hospital bed funds, this conclusory reporting is inconsistent with Conn. Gen. Stat. § 19a-509b(e), which requires hospitals making reports to identify patient accounts to which the funds were applied and amounts applied for each patient's free care.

Fransioli, Herbert (Tab 74) This gift of \$701,648 was directed to be held in a segregated account and 75% of it was to be used for construction of a new wing. The Hospital incorrectly treats this as unrestricted. In a supplemental production, dated August 3, 2001, the gift is reported as being fully expended.

Gillette, Jane C. (Tab 2) A trust set up under Paragraph 16 of the will specified that the income was to be used "primarily for two beds in the memory of Flora Weed and Mary Weed, any balance to be used for the Hospital's general purposes." The Hospital is inconsistent in its treatment of the fund. The February 1, 2001 Application cites it as restricted. The responses to interrogatories, dated July 9, 2001, reports that the trust was terminated with court approval and the fund, which was treated as unrestricted, was fully expended "for appropriate purposes."

Harrison, Harriette (Tab 11) This gift of 35% of the residue of the estate, with directions to accumulate until that sum quadrupled, the income to be used "to provide free hospital care to needy residents of the Town of Salisbury." The Hospital correctly treated the fund as restricted in the February 1, 2001 Application, but incorrectly changed the designation to unrestricted in subsequent filings because the initial distribution was the result of litigation arising from the Harrison estate. On June 21, 2001, in response to a separate survey by the Attorney General of all bed funds held by Connecticut Hospitals, Sharon Hospital included this fund among its free beds.

Miner, Charlotte (Tab 129) The donor directed that this gift of one half of the residue of her estate "both principal and income shall be used for heart research through Sharon Research Institute at Sharon Hospital." The Hospital incorrectly treated the gift as unrestricted. In a supplemental production, dated August 3, 2001, the gift is reported as being fully expended.

Ompir, Peter (Tab 138) The residue of this estate passed to the Building Fund of Sharon Hospital. The Hospital incorrectly treats the gift as unrestricted. In a supplemental production, dated August 3, 2001, the gifts are reported as being fully expended.

Ryan, Theodore (Tab 153) The balance of a charitable remainder trust passed to the Hospital after the death of the life beneficiary "for addition to its restricted Plant Improvement and Replacement Fund." The Hospital incorrectly treats the gift as unrestricted. In supplemental production, dated August 3, 2001, the gift is reported as being fully expended.

Sherman, Lola (Tab 20) The Hospital received one ninth of the residue of the estate to be held in trust, the "income therefrom to be used for any general hospital purposes, but the same shall be first available for the relief at said Hospital of the ill

and afflicted in health, who may reside in the town of Amenia and in the vicinity of Amenia Union. . . who may apply for such relief." The Hospital correctly treats this fund as restricted in its Application, but in its June 21, 2001 response to the Attorney General's survey of hospital bed funds, omits any mention of the Sherman trust.

Triacca, Mary (Tab 174) The will gives two gifts, one for the improvement of the "unit intensive care for vascular diseases, the other for improvement of "facilities for the care of kidney diseases." The Hospital incorrectly treats both gifts as unrestricted. In a supplemental production, dated August 3, 2001, the gifts are reported as being fully expended.^{32/}

(f). The Hospital's Free bed funds must be categorized as restricted endowment funds

"Hospital bed fund" means any gift of money, stock, bonds, financial instruments or other property made by any donor for the purpose of establishing a fund to provide medical care to patients at a hospital. A hospital bed fund may be established by inter vivos gift, bequest, subscription, solicitation, dedication or any other means." Conn. Gen. Stat. § 19a-509b(a). Hospital free bed funds, therefore, are restricted charitable gifts because their use is dedicated to a specific charitable purpose. The Hospital has only identified three free bed funds as part of the Hospital's charitable gifts (and properly characterizes them as restricted endowment funds): Northrup, Sherman and Williams.

The Hospital, however, has mischaracterized several free bed funds as unrestricted charitable gifts. As discussed above, most of these gifts are fully expended. Of those that remain, two, the Harriette Harrison Fund (Tab 11) and the income from the Bedelia Croly Falls Trust (Tab 68), are free bed funds under the statutory definition. The Hospital omits the Falls Trust entirely from its list of restricted gifts. The Hospital also incorrectly lists the balance in the Williams Fund (a disclosed free bed fund) as of May 31, 2001, because the account statement for the same date states that the separate restricted Williams Fund bank account held \$372,546.36.

^{32/} The Hospital does not dispute my treatment of these gifts.

Accordingly, the total 2001 Balance line item on the Hospital's Funds Value Report must be adjusted upwards by an additional \$228,987.36 and I must also increase my calculation of the charitable funds held and administered by the Hospital by the same amount to \$13,098,374.00. This also adjusts the total value of Restricted Funds upwards from \$299,699.00 to \$528,686.00 and the total charitable gift amount increases to \$13,098,374.00.

(g). The Hospital Must Deduct the Principal of Trusts Held by Outside Banks from the Amount Available to the Conversion Foundation

The total amount of money available to be transferred to the conversion foundation must be adjusted downwards to reflect that certain principal of trusts held by outside banks will not by law pass to the conversion foundation. The Hospital lists such principal as part of the funds being transferred to SACHF as "Amounts Held in Trust by Others". This line item, totaling \$6,501,116.00, represents the total principal of the I. Kent Fulton Trust and the William G. and Mary C. Raynsford Trust Fund, which are held and administered by Fleet Bank NA as successor trustee.^{33/}

After reviewing these instruments, I conclude that the principal of each trust will not be available to be transferred to the conversion foundation. The I. Kent Fulton Trust (Tab 1) was established under Article Four and the First Codicil to Mr. Fulton's will. Article Four directed that

^{33/} The Hospital has consistently treated the principal of these trusts as a sum that it will transfer to SACHF. At each revision of the Sources and Uses Chart, starting with the Application, including the August 3, 2001 version and the update submitted at the Attorney General's August 14, 2001 technical hearing, the principal of the above trusts was listed as an asset to be transferred to the foundation. To reach the initial transfer amount figure of \$21,802,836.00, the August 3, 2001 figure of \$24,506,727.00 or the \$23,455,785 figure produced on August 14, 2001, one had to add in the approximately \$6.5 million of principal held in trust by others. Because the Hospital has consistently held out to the public that the proposed sale will result in the conversion foundation holding over \$20 million in assets dedicated to providing healthcare to the Sharon Hospital service area, and because the above gift instruments provide the Hospital with only an income interest in these significant trusts, the validity of the numbers was explored at the hearing on August 15, 2001.

\$25,000 be placed in trust at the Hartford Bank & Trust Co., the net income to be paid to the Hospital annually for its general purposes. There is no provision in the will and/or codicil that provides that Sharon Hospital will receive any of the principal of this trust.^{34/}

Based on the lack of any language in the will and codicil giving Sharon Hospital any right to the principal, I conclude that the Hospital has only an interest in the income of the Fulton trust and no claim to the principal. The market value of the principal of the trust, as of May 31, 2001, was \$6,219,077.80, and, since the last distribution date, the accumulated income was \$5,455.09. Fleet intends to continue to act as trustee, and I conclude that the principal will not be available to be transferred to the proposed conversion foundation.

The William G. and Mary C. Raynsford Trust Fund (Tab 3), established under Article Four of the will of William G. Raynsford, dated March 26, 1964, was created with the rest and residue of the estate with a restriction that 10% of the income be added to the principal until the principal reached \$250,000. The balance of the net income not reinvested was to be paid to two churches, with any excess income over \$3000 annually to be paid to Sharon Hospital, Inc. There is no provision in the will and/or codicil that provides that Sharon Hospital will receive any of the principal of this trust.

Based on the lack of any language in the trust instrument, as well as testimony provided by Fleet Bank, NA at the hearing, I conclude that the Hospital has an interest in a portion of the income of the Raynsford trust and no claim whatsoever to the principal. As of May 31, 2001, the Raynsford Trust held \$836,509.55 in principal and, since the last distribution date, accumulated

^{34/} The principal amount of \$25,000 has been significantly augmented by a "pour-over" provision in the Codicil that gave the rest of Mr. Fulton's estate to the Article Four trust after the death of his wife and son.

interest of \$1,622.93. Fleet Bank intends to continue acting as trustee, and I conclude that the principal of the Raynsford Trust will not pass to the conversion foundation.

Similarly, based upon an examination of the language of the Bedelia Croly Falls Trust instrument and the contents of the Application and the record, I have determined that the principal of the Bedelia Croly Falls Trust will not transfer to the conversion foundation. The terms of the Bedelia Croly Falls will require the "rest, residue and remainder be entered into trust." The five charitable beneficiaries designated by the testatrix receive various shares of the trust, of which Sharon Hospital receives 40% "for indigent individuals/families or middle class families facing financial ruin because of medical expenses." There is no provision in the will or trust giving Sharon Hospital any right to any principal. Accordingly, I find that the proposed conversion foundation will not receive the principal of the Falls trust.^{35/}

Therefore, based upon an examination of the trust instruments and the evidence in the record, I conclude that the \$23,485,785.00 sum stated by the Hospital as the amount passing to the foundation must be reduced by \$6,501,116 to a projected \$16,984,669.00 (as of August 14, 2001). This number will undoubtedly change as of the date of closing.

(h). The Hospital Must Omit Trusts with Gift-over Provisions from the Charitable Gifts Passing to the Conversion Foundation

In addition to requiring the Attorney General to confirm the sum being transferred to the successor foundation, the Conversion Act requires the Attorney General to disapprove a proposed transaction if it is prohibited by Connecticut statutory or common law governing nonprofit entities, trusts or charities. The statute requires the Attorney General to examine each

^{35/} The Hospital concedes, in a letter dated August 24, 2001, that the principal of these trusts will not pass to the proposed conversion foundation. Similar admissions were made in the testimony of Robert Wright and the representations of John Horak, counsel to the Hospital, at the Attorney General's technical hearings, August 14 and 15, 2001.

element of the proposed transaction, and, with respect to any assets with a use restriction imposed by a donor, to ensure that the directives of the donors of those charitable gifts are carried out as required by Conn. Gen. Stat. § 19a-486c(a)(8)(b)(iii). It is therefore essential to determine whether any restrictions may prevent particular charitable gifts from being transferred to SACHF.

The Hospital lists the Clark Weed Trust (Tab 22) and the income from the William G. and Mary C. Raynsford Funds (Tab 3) as passing to the proposed conversion foundation.^{36/} Both trusts contain "gift-over" language that reflects the donor's intent to transfer the charitable fund or income interest to alternative charities if certain enumerated circumstances occur. The Clark Weed Trust is presently held by the Hospital and treated as an unrestricted endowment fund, the principal of which must be preserved, the income of which can be applied for the hospital's general purposes. The Hospital's August 14, 2001 Funds Value Report lists the original value of the gift as \$114,652. As to the Raynsford trust, the Hospital has an income interest that permits it to receive from Fleet Bank all net annual income in excess of \$3,000. The treatment of the principal of the Raynsford Trust in the proposed conversion has been discussed above. This section now focuses on the correct disposition of the income stream from the Raynsford Trust and the principal and income from the Weed Trust.

Article Third of the will of Clark Weed, dated April 19, 1932, provides that after the death of his wife, one half of his estate would pass to Sharon Hospital "to hold the same as a trust fund in memory of my sister, Mrs. John Clark and to use the income received therefrom for the general

^{36/} The Weed Trust's current \$114,000 of principal is listed as an unrestricted endowment passing to SACHF on the Funds Value Report. The original historic dollar value of the principal was \$114,652 which, under the provisions of the Connecticut Uniform Management of Institutional Funds Act, the Hospital was legally obligated to preserve. The testimony of Robert Wright and Attorney John Horak at the Attorney General's August 14, 2001 technical hearing confirmed the Hospital's position that the Hospital would attempt to transfer the income interest to SACHF. The August 24, 2001 letter from Hospital counsel clarifies that, at most, an income interest would be transferred.

uses and purposes of said hospital." The will further provides: "In the event that at any time for any reason said Hospital should cease to exist, then I direct that said Fund be given to the Newington Home for Crippled Children to be held as a fund in memory of my said sister, the income therefrom to be used for the general uses and purposes of said Home . . ." Article Four of the Will of William G. Raynsford, dated March 26, 1964, contains the following similar gift-over provisions: "Should The Sharon Hospital, Inc. cease to exist, I authorize and direct my Trustee to select two or more organizations doing business within the Town of Salisbury, Connecticut, and which qualify as charitable organizations under Federal Estate tax law, between or among whom the distributable income of this trust shall be paid, not necessarily in equal shares, but in such proportions as my Trustee shall determine."

The Connecticut Children's Medical Center is the corporate successor to the Newington Home for Crippled Children, which is named in the Clark Weed Trust. Under Connecticut charities law, a gift to one charity, with language providing for a substitution or gift over to another charity upon certain conditions, has long been valid. *See Colonial Trust Co, v. Waldron*, 112 Conn. 216, 233 (1930); *Christ Church v. Trustees*, 67 Conn. 554, 565-66 (1896).

In the present case, the Raynsford trust instrument provides for a gift over to two or more charities in the Town of Salisbury, if Sharon Hospital should ever "cease to exist." The donative language specifies that the alternative charities must qualify as charitable organizations under federal tax law. This indicates that the existence of the Hospital as a charitable organization was a condition to its continuing receipt of the income from the trust. With a change of the Hospital to a for-profit form, the gift, for which the estate undoubtedly received a tax benefit, would fail, and the donor's gift-over language would be triggered.

In the Weed Trust, the gift over language states even more broadly: "In the event that at any time, for any reason, said Hospital should cease to exist, then I direct that said Fund be given to the Newington Home for Crippled Children." Like William Raynsford, the purpose of Clark Weed's gift was to provide through his will a trust fund to provide income to a specific charitable hospital. If that charity ceased to exist, at any time and for any reason at all, then Mr. Clark intended that the gift pass to an alternative charity of his selection, namely the Newington Children's Hospital. The proposed sale of the Hospital's assets to Essent CT in for-profit form, effectively terminates the Hospital's existence as a viable, functioning charitable and tax-exempt hospital providing healthcare services to the Greater Sharon community. Cessation of operations as a charity is sufficient to trigger the gift-over provisions in both of the above gifts.

The Hospital has indicated in its filings that it believes the equitable doctrine of *cy pres* or approximation permits the income to be transferred to the conversion foundation. I conclude that, given the gift-over provisions contained in these gifts, the doctrine of *cy pres* or approximation is not applicable here.

Connecticut has adopted the "equitable doctrine of approximation" or modified *cy pres*.^{37/} *Newton v. Healey* 100 Conn. 5, 10-11 (1923). The doctrine of approximation is well established in Connecticut law. See, e.g., *Lockwood v. Killian*, 179 Conn. 62 (1979); *Ministers & Missionaries Ben. Bd. v. Meriden Trust & Safe Deposit Co.*, 139 Conn. 435 (1953); *Seymour v. Attorney General*, 124 Conn. 490, 498-499 (1928). The doctrine applies in instances where a testator has evidenced a dominant intent to devote his property to some charitable purpose but,

^{37/} Scott explains the term "*cy pres*" this way: "The principle under which the courts attempt to save a charitable trust from failure by carrying out the more general purpose of the testator, and carrying out approximately, though not exactly, his more specific intent is called the doctrine of *cy pres*. The phrase is in the Anglo-French and is equivalent to the modern French *si pres*, meaning so near or as near. The intention of the testator is carried out as nearly as may be." IV Scott on Trusts (3rd) § 399 at 3084; Bogert, Trusts and Trustees (2d) § 431.

due to changed circumstances, it has become impossible, impracticable or illegal to follow the particular method directed. The Courts will then sanction its use in some other way that will, as nearly as may be, approximate the donor's general intent. *Duncan v. Higgins*, 129 Conn. 136, 140 (1924); *Shannon v. Eno*, 120 Conn. 77, 86-87 (1935); Restatement (2d) of Trusts §399. In exercising this power, the court applies "a judicial principle of construction to ascertain and effectuate [the donor's] intention . . . when, and in so far as, the specific method adopted by the testator for carrying out his general intent can no longer be executed. . . . [This] justifies substitution of a method which seems to be as nearly approximate as existing conditions will permit." *Newton*, 100 Conn. at 10-11.

The cy pres doctrine cannot be applied where the instrument involved contains a provision for a "gift over" upon failure of the particular purpose. 4 Scott, Trusts (3d Ed.) § 399.2, p. 3095; Restatement (Second), 2 Trusts § 399, comment c; see *First Congregational Society of Bridgeport v. City of Bridgeport*, 99 Conn. 22, 31-32 (1903).

Since the testator has himself provided for a disposition of the fund in case of the failure of the bequest, that doctrine could have no application at least in its broader aspect. *Hartford National Bank & Trust Co. v. Oak Bluffs First Baptist Church*, 116 Conn. 347, 351, 164 A. 910, 911. It cannot be disputed that, if any of the conditions have occurred upon which the alternative gift was to take effect, the testatrix' direction that this bequest be distributed under the residuary clause must be followed. The provision for a gift over upon failure of the charity negatives the existence of a general charitable intent, just as the absence of such a provision is evidence of such a purpose. Bogert, Trusts and Trustees (2d Ed.) § 437, p. 426.

Connecticut Bank & Trust v. Cyril and Julia C. Johnson Mem. Hosp., 30 Conn. Sup. 1, 8 (1972).

A gift over from one charitable corporation to another charitable corporation is valid and may take effect upon the failure of the original charitable trusts. IV Scott on Trusts, § 401.5 at 586 (4th Ed. 1967). I conclude, therefore, that the cessation of the Hospital's operations in nonprofit form will trigger the above gift-over clauses. Consequently, the income interest in the

Raynsford Fund will pass to those charities selected by its trustee in accordance with the language of the will. The corpus of the Clark Weed Trust will pass to the Connecticut Children's Medical Center, successor to the Newington Home for Crippled Children by merger reducing the total charitable gifts passing to the proposed foundation to \$12,983,722. None of the monies from either trust will be available to the conversion foundation.^{38/}

(i). Hazel M. Peck Open Estate

According to the information provided to me, the Hazel M. Peck Estate is still open and pending in Probate Court. If the probate of this estate is completed and a final order of distribution awards the presently unquantified remainder interest in this estate to the nonprofit Hospital, then those funds will pass to SACHF. If the estate is still open at the closing of this transaction, then the decision about how to apply the remainder interest must be decided by the court under the equitable doctrine of approximation.

(j). Future Interests and Their Possible Treatment.

Among the charitable trusts included by the Hospital in its Gift Instruments and Gift Analysis are a significant number of charitable remainder trusts, and charitable remainder unitrusts, the language of which leaves a future interest in the remainder to Sharon Hospital Inc. after the death of the life beneficiary or beneficiaries. These trusts are correctly assigned zero value on Gift Analysis prepared by the Hospital. As the brief review of their language reflects, the future value of the funds might be significant.

Emerson, Richards H. (Tab 67) Article 7 of Mr. Emerson's Will, as amended by Codicil 2, establishes a charitable remainder unitrust f/b/o Howard Slayman. At his death the Hospital is to receive 1/7th of remainder. According to Sharon

^{38/} Finally, the Hospital represents that the income from the Bedelia Croly Falls Trust should pass to the conversion foundation. I construe the trust to require that if Sharon Hospital ceases to exist as a functioning non-profit hospital, then the income interest must be passed to the other designated charities pro rata unless the Superior Court deems otherwise.

Hospital's endowment review, 4-24-01, page 001385, the Hospital's interest has not yet matured.

Howard, Mary W. (Tab 99) Article Fifth, C of the will, as amended by Codicil, establishes a charitable trust to be called the "Samuel and Mary Howard Fund", the annual income of which shall be distributed in the trustee's discretion among five charitable organizations, including Sharon Hospital. Notes indicated that this will was admitted to probate November 20, 2000. Page 001396 of the review of charitable gifts states that the trust has not been funded yet.

Scheller, Florence E. (Tab 155) Article Third of Mrs. Scheller's will establishes a charitable remainder trust f/b/o Charles R. Scheller and Marian J. Pellon. Upon death of the survivor, a 1/3 share of the trust principal and income pass to the Hospital. Page 001406D of the review of charitable gifts, dated 4-24-01, states that the hospital's interest has not yet matured.

Talmage, Archibald (Tab 170) Article Second (b) (6) of the Trust Agreement, dated 8-24-1990 establishes a charitable remainder trust for the benefit of three of the donor's relatives. After the death of the last survivor of them, the hospital is to receive 10% of the trust property if it is "then in existence." Page 001406G of the Hospital's review of charitable gifts states that the hospital's interest has not yet matured.

Sharon Hospital will likely cease to exist as a functioning non-profit hospital before each of these future interests ripens into enjoyment at the death of the last life beneficiary. Only when the future interest becomes a present interest can a probate or superior court determine whether the remainder will pass to the conversion foundation or to another charitable organization, or whether the gift will fail and revert to the donors' heirs-at-law. Therefore, the foregoing future interests cannot be included in the list of charitable trusts and gifts that can be legally transferred to the conversion foundation.

(k). The Funds Raised by the Sharon Hospital Auxiliary Should Pass to the Foundation

The Hospital's application disclosed no information about the Sharon Hospital Auxiliary or how its funds would be treated in the conversion. The Sharon Hospital Auxiliary is a volunteer group that "operates a gift shop and thrift shop and conducts other fundraising activities on behalf

of Sharon Hospital." The Auxiliary is not an independent organization, but a division of the Hospital, and donations from the Auxiliary are internal transfers of funds from one division of the hospital to another.

As of March 31, 2001, the Auxiliary held \$133,276.23 in five accounts. The Hospital represents, and I find, that "[t]hese funds were generated by the Auxiliary's retail activities and other fundraising events, and are unrestricted, non-endowment funds."

The definition of solicitation under Conn. Gen. Stat. § 21a-190a(3) of the Solicitation of Charitable Funds Act encompasses appeals on behalf of a charitable organization, sales of goods and special fundraising events like those conducted by the Auxiliary. Under § 21a-190a(4), healthcare is a recognized charitable purpose. I conclude, therefore, that the funds raised by the Auxiliary are charitable funds that must pass to the conversion foundation and may be treated as unrestricted charitable gifts. This change will bring the value of the unrestricted gifts from \$11,505,559 to \$11,638,835, and the total charitable gifts to \$13,116,998.00 and the total to the conversion foundation to \$17,003,293.23 (as of August 14, 2001). This amount is subject to change as of the date of the closing.

(I). The Proceeds of the Nursing Home Sale and the Proceeds of the Resulting Risk Fund Are To Be Accounted For and Transferred to SACHF

The Hospital's Notice and Application state that the net proceeds of the sale of the Nursing Home and the 82 Amenia Road property to United Methodist Homes, Inc. will be added to the funds proposed to be transferred to the conversion foundation. It is unknown whether the transaction immediately produced net proceeds to be transferred to SACHF. The record of this case contains no closing statement or other evidence regarding the amount, if any, of such proceeds. Nowhere in the sales agreement do the buyer and seller state that the proceeds will pass to SACHF as represented in the Hospital's conversion application.

Pursuant to the sales agreement, the parties established an escrow account called the "Risk Fund", containing \$1,250,000. The Risk Fund is to be held for five years for the purpose of covering the cost of certain contingencies. Forty-five days after the close of that escrow period, all money remaining in the Risk Fund escrow account is to be distributed to Sharon Healthcare, Inc.

To ensure that such funds are transferred to SACHF, I require, as a condition of approval, that Sharon Healthcare Inc. and United Methodist Homes execute an addendum to the sales agreement for the sale of the Nursing Home that clarifies and confirms that the proceeds of the sale of the Nursing Home and remainder of the Risk Fund, at the end of the five year escrow period, will pass to the conversion foundation as unrestricted funds. As a further condition of approval, I require the Hospital and/or Sharon Corporation to provide me with copies of all closing documents, an accounting showing the funds transferring as a result of the transaction and documentation of the establishment of the escrow fund. Finally, as a condition for approval of the sale of the Hospital, I will require, for the next six years, Sharon Hospital Inc. to submit an annual report to the Attorney General on the uses of all funds held in the Risk Fund, including a statement of fund balances with supporting documentation in the form of the monthly or quarterly reports of the account(s) in which the Risk Fund is held.

3. Evidence regarding the Hospital's ability to transfer funds to SACHF

As part of my review, I must also ensure that the Hospital currently maintains sufficient funds to account for all of the charitable gifts and trusts it has disclosed that must be transferred to the conversion foundation as a condition of my approval of the sale.

The Hospital has disclosed information about the bank accounts in which the charitable funds are held, the name of the corporation owning each account and the amount in each account

as of May 31, 2001. The Hospital states that "[a]ll accounts are held in the name of Sharon Corporation. Seller does not maintain specific gifts in particular bank accounts. Rather, the accounts are pooled accounts containing all of Seller's investments and securities. Note that the name of the accounts such as "Unrestricted Endowment Fund" and "Restricted Endowment Fund" are titles of accounts only and do not relate to actual use or endowment restrictions on such funds."

The Hospital's most recent statement reflects that the following accounts hold funds identified as the Hospital's charitable gifts and trusts:

Sharon Corporation Depreciation Fund: AHA Investment Funds, Acct.
0510-051-0000500194: \$9,810.89

Sharon Hospital Foundation: AHA Investment Funds, Acct.
051-051-0000500185: \$293,636.48

Sharon Corporation Unrestricted Fund: Investors Bank & Trust Company,
Acct.020407420103: \$6,365,815.49

Sharon Corporation Endowment: Investors Bank & Trust Company
020407420102: \$5,442,675.34

Sharon Hospital Margaret H. Williams Fund: MAS Funds, Morgan Stanley Dean
Witter, Acct. 986522796: \$372,546.36

Sharon Hospital Foundation EMT Fund; Investors Bank & Trust Company, Acct.
020407420104: \$352,727.41

Sharon Hospital Foundation, Inc. was established as a Connecticut non-stock corporation on July 16, 1984, with 501(c)(3) status under the Internal Revenue Code, for the purpose of soliciting and receiving contributions and managing them on behalf of Sharon Hospital and its parent, Sharon Corporation. The Foundation merged with Sharon Corporation on April 30, 1996. The Hospital's response to the Attorney General's discovery reflects that, shortly before the merger on September 30, 1995, the Foundation had \$1,929,838 in fund balances.

I assume that all assets involved in the merger were duly transferred to Sharon Corporation, and that the Corporation has the legal authority to transfer the \$293,636.48 held in the name of Sharon Hospital Foundation (in AHA Investment Funds, Acct. 051-051-0000500185) to the conversion foundation. I further assume that the designation of the owner of that account is incorrect. If the above account was never legally transferred by the Sharon Hospital Foundation, Inc. to the Sharon Corp. then, as a condition of approval, such a transfer must occur prior to closing.

The disclosure of the actual bank accounts has raised additional questions regarding the type and nature of these accounts. For example, the Hospital discloses an account entitled the Sharon Hospital Foundation EMT Fund, which is held in Investors Bank & Trust Company, Acct. 020407420104, with a reported balance, as of May 31, 2001, of \$352,727.41. Nowhere, however, does the Hospital explain or describe the origins or charitable purposes of that fund. As a further condition of approval of the proposed transaction, I will require the Hospital to submit documentation of the sources and charitable purposes of this fund. I also assume that all assets involved in the merger of the Sharon Hospital Foundation, Inc. into Sharon Corporation were duly transferred to Sharon Corporation, and that the Corporation has the legal authority to transfer the Sharon Hospital Foundation EMT Fund to the conversion foundation. I assume that the designation of the owner of the account is incorrect. If the above account was never legally transferred out of the Sharon Hospital Foundation, Inc., then, as a condition of approval such a transfer must occur prior to closing.

Similarly, the Margaret H. Williams Fund is a restricted endowment fund that was established by a testamentary disposition in 1983 as a free bed fund with an original gift of \$143,559. The Hospital's accounts reflect that, consistent with an order of the Superior Court, it

is invested separately, and not as part of a pooled fund. As of May 31, 2001, the Hospital's account balance showed that the fund contained \$372,546.36. The Funds Value Report, compiled by the Hospital as of the same date, shows only a balance of \$143,559 with no accumulated income. As a condition of approval of the proposed transaction, I require a full accounting of the Williams Fund from January, 1998 to the present.

As of May 31, 2001, the foregoing accounts totaled \$12,837,211.00 and contained sufficient funds at that time to cover the actual amount of charitable gifts and endowments that will pass to the conversion foundation. The Hospital has stated, however, that these accounts constitute all of its investments accounts. Although requested to do so, the Hospital did not identify which charitable gifts were held in each of the pooled accounts. As a result, the conversion foundation will have to use the historic dollar value of gifts to allocate proportionally amongst the funds and categories of funds any accumulated income as of the date of closing.

4. The Conversion Foundation

The Application provides that the net proceeds of the sale of the Hospital to Essent CT, along with the net proceeds from the sale of the Nursing Home, will be transferred to a proposed conversion foundation, organized as a supporting organization of the Berkshire Taconic Community Foundation, to be called the Sharon Area Community Health Foundation ("SACHF").

The Berkshire Taconic Community Foundation ("BTCF") is a Connecticut non-stock corporation located at 271 Main Street, Great Barrington, Massachusetts. It is organized as a community foundation for the purpose of holding and administering funds for the benefit of communities in Northwest Connecticut, Dutchess and Columbia Counties, New York and Berkshire County, Massachusetts. BTCF has tax exempt status as a public charity under I.R.C.

Section 501(c)(3) and is therefore eligible to receive the charitable trusts and gifts that donors have made to the Hospital for charitable purposes.

Conn. Gen. Stat. § 19a-486c(a)(8)(A) requires the Attorney General to review and ensure that the transfer of assets be "to one or more persons to be selected by the Superior Court who are not affiliated through corporate structure, governance or membership with either the nonprofit hospital or the purchaser." The purpose of these provisions is to insure the independence of the nonprofit conversion foundation from the for-profit hospital and also from the former nonprofit hospital. After I have reviewed and approved it with any modifications I deem necessary, the conversion foundation proposal must also be presented to the Superior Court for review, approval and possible modification.

A review of the corporate documents of Sharon Hospital, Inc., Essent Healthcare Inc., Essent CT and Berkshire Taconic Community Foundation satisfies me that there will be no affiliation between these entities by corporate structure or governance, because there is no proposed overlap of board members between them and no proposed interlinking of corporate governance or control. I have also reviewed the lists of board members of Sharon Hospital, Inc., BTCF and those proposed for Essent CT and I find no common members.

The Board of Directors of SACHF has not yet been formed. At the August 14, 2001 adjudicatory hearings, Joan Dunlop, a board member of BTCF, testified that BTCF proposes to form a nine member community planning committee with a life of one year to recruit the SACHF board and to begin collecting data on healthcare needs. She proposed a period of six months to recruit initially, with the candidates subject to my input and approval.

While I appreciate the challenge of recruiting candidates for the SACHF board, the process must move forward quickly so that the charitable funds can be put to use and the

candidates presented to the Superior Court for approval. Also, I am impressed with the breadth, depth and quality of citizen interest and support, which augers well for volunteer involvement. Therefore, as a condition of approval, I require the recruitment process to be completed no later than ninety days from the issuance of this final decision. Further, to ensure the complete independence of the SACHF board, its members are prohibited from sitting as members of the community advisory board of trustees proposed by Essent CT to consult in the "management, clinical quality monitoring and strategic planning" at Sharon Hospital when it converts to for-profit form. BTCF shall submit to me a list of the proposed board members, and I may disapprove any board member if I determine, in my sole discretion, that the proposed board member is affiliated through corporate structure, governance or membership with either the non-profit hospital or the purchaser.

Conn. Gen. Stat. § 19a-486c(a)(8)(B) also requires the Attorney General to ensure that the sum being transferred to the conversion foundation is being used for one of the following purposes: "(i) For appropriate charitable health care purposes consistent with the nonprofit hospital's original purpose or (ii) for the support and promotion of health care generally in the affected community" The proposed corporate charter for SACHF contains language in Section 2(a)(1) limiting the use of its assets to healthcare purposes in the current service area of the Hospital, focusing on the provision of enhancements to current programs or services and the care of vulnerable populations through the provision of grants to non-profit organizations, health centers, and programs not affiliated with the for-profit hospital. These provisions comply with the requirements of Conn. Gen. Stat. § 19a-486c(a)(8)(b)(ii).

However, section 2(a)(i) permits the SACHF board to "invest in the acquisition of all or part of the acute care hospital facilities and operations of Sharon Hospital" if the board believes

this is necessary or appropriate to help address healthcare needs in its service area. The ambiguous language of this provision as currently drafted would arguably permit the board to invest the funds of the foundation in the for-profit Sharon Hospital. According to testimony given at the joint hearing with the Office of Health Care Access on June 12, 2001, and the testimony at the August 14 hearing, this is not the intent of the applicant or BTCF.

Rather, according to the testimony, the intent of this section is to permit the SACHF board to repurchase the assets of the for-profit Sharon Hospital to reconvert the hospital to a non-profit form. Nonetheless, because the language as it currently exists might permit another interpretation, this section of SACHF's charter must be rewritten to clarify that point as a condition of my approval.

Under I.R.S. Regulation § 170A-9(e)11(v)(B), any charitable organization classified as a community trust or community foundation is required to reserve a variance power. The variance power permits a board unilaterally to adjust or change the purposes to which its charitable funds are being applied, if, in the opinion of its board, the purposes have become outmoded. In accordance with the above provisions, Article II (d) of the Articles of Incorporation of BTCF specifically reserves to its Board the right: "To modify any restriction or condition on the distribution of funds for any specified charitable purpose or to specified organizations, if in the sole judgment of the Board of Directors (without the necessity of the approval of any participating trustee, custodian, or agent), such restriction or condition becomes . . . unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community." The broadly stated charter purpose of the BTCF is "to receive and accept property to be administered exclusively for charitable purposes, primarily in, or for the benefit of, the communities of the Berkshire County in Massachusetts, Litchfield County in Connecticut, and Dutchess and Columbia

Counties in New York." As to assets held and administered by BTCF itself, this variance power would permit its board to change the purpose of funds it holds for healthcare to another beneficial community purpose, such as historical preservation. Because Conn. Gen. Stat. § 19a-486c(a)(8)(b)(i) and (ii) require me to assure that all assets passing to the conversion foundation are to be applied exclusively for healthcare purposes, the variance power held by SACHF's parent concerns me. The matter must be fully addressed by a restructuring of the current proposal.

Under SACHF's current draft corporate charter and bylaws, the proposed interrelated corporate structure places the healthcare assets of SACHF in danger of becoming subject to the variance powers of BTCF under certain circumstances. Section 5 of SACHF's charter and Art. 2.5 of its By-Laws establish SACHF as a non-stock **membership** corporation under Conn. Gen. Stat. §§ 33-1026 and 33-1055. The sole **member** of SACHF is the Berkshire Taconic Community Foundation, which "shall appoint all members of the Board of Directors." (Section 5 of the Certificate of Incorporation, Art. 2.5 of the By-Laws). Section 2.2B clarifies that the Member has the power to elect and remove the Directors of SACHF. These provisions permit BTCF to control who runs SACHF. In combination with the power to approve its policies, strategic and business plans, approve its budgets and investment policies, authorize the incursion of debt and the formation of any joint venture or other entity necessary to carry out its projects, the Member's power to appoint and remove board members gives it significant control of SACHF's operations.

Section 9 of SACHF's charter and Art. 2.2 C (iv) of its By-Laws provide that the **Member**, with the consent of the board of directors it appoints, can dissolve the conversion foundation. Section 10 of the charter provides that, after payment of all of SACHF's liabilities, all

remaining assets are distributed to: "(a) Berkshire Taconic Community Foundation, Inc., one or more of its affiliates, or [sic] its successor thereof, as they are in good standing qualifying under Section 501(c)(3) of the Code; or (b) such organization or organizations as selected by Berkshire Taconic Community Foundation, Inc. and organized and operated exclusively for charitable, educational, religious or scientific purposes as shall at the time qualify as an exempt organization or organizations under Section 501(c)(3) of the Code."

These provisions would allow BTCF, as the sole member of SACHF, to force the conversion foundation to dissolve and pass its assets to BTCF. At that point, those assets would become subject to the community foundation's variance powers. This would permit funds transferred to SACHF exclusively for healthcare purposes under the Conversion statute to be varied and applied for other purposes.

This is legally improper in light of the language of Conn. Gen. Stat. § 19a-486(a)(8)(B)(i) and (ii), which require that conversion foundation funds be used exclusively for healthcare purposes in the affected community, as well as other state law that requires permission from the Superior Court to vary the use of any charitable gift under the equitable doctrines of approximation^{39/} or deviation.^{40/}

In response to questions raised about the variance power, BTCF's representatives assert that, because SACHF does not have a variance power itself, and because it is separately incorporated from BTCF, the uses of the post-transaction proceeds cannot be varied from the

^{39/} *Duncan v. Higgins*, 129 Conn. 136, 140 (1924); *Second Ecclesiastical Society v. Attorney General*, 133 Conn. 89, 93-94 (1946). In addition to the general equity jurisdiction of the Superior Court, Conn. Gen. Stat. § 45a-98(b) extended the power to apply the equitable doctrine of approximation to the jurisdiction of the Probate Court in 1998.

^{40/} *Blumenthal v. White*, 43 Conn. App. 365, 370-372 (1996).

stated list of purposes set out in the SACHF charter. The foregoing discussion reflects the problems under Connecticut law in establishing a supporting conversion foundation that is "controlled by" rather than "operated in connection with" the parent community foundation.^{41/}

To avoid any possibility of these eventualities, I require the following as conditions of approval: First, the draft Certificate of Incorporation and By-Laws for SACHF must be amended to omit all references to BTCF as a **member** of SACHF. Instead, the corporation must be formed as a non-stock, **non-membership** corporation with its own self-perpetuating board of directors that will manage and exercise the powers of the corporation.

Second, the number of directors on the SACHF board shall be uneven in number, and in the range of 11 to 17 members, with staggered terms as proposed in the draft By-Laws Section 3.3. Three seats on the board of SACHF shall be filled by members of the board of BTCF or shall be designated as seats appointed by the board of BTCF. I accept BTCF's offer at the August 14, 2001 hearing to be the entity that screens and selects the initial members of the SACHF board. However, I reserve the right to review BTCF's slate of proposed board members and to disapprove one or more of the persons nominated by BTCF if they are affiliated with either the non-profit hospital or the purchaser. After the formation of the initial board of directors by BTCF within three months of the closing of the proposed transaction, the SACHF board will be self-perpetuating.

Third, to ensure the continuing use of all of SACHF's funds for healthcare purposes in the affected community, the dissolution provisions of the certificate of incorporation in Section 9 must be amended to remove references to BTCF as a Member. Section 10 must also be amended

^{41/} See Christopher R. Hoyt, "Creating Supporting Organizations of Community Foundations From Nonprofit Hospital Sales," in *Exempt Organization Tax Review*, August 1997, Vol. 17., No. 2, at 1331.

to provide that upon dissolution of SACHF, after payment or provision for the payment of all of its liabilities, all of the assets will pass to one or more organizations to be selected by the Superior Court, after notice to the Attorney General, and which are organized and operated exclusively for charitable healthcare purposes as shall at the time qualify as a tax exempt organization under Section 501(c)(3) of the Code. To ensure that the charter purposes of the conversion foundation are not altered, I further require that Section 8 of the Certificate of Incorporation be revised to provide that any amendment that modifies Article 2 by amending, expanding, contracting or altering the purposes of SACHF must receive prior written approval of the Attorney General, and, if necessary, the Superior Court.

One of the purposes of SACHF is to hold and administer the funds it receives for a possible "buy-back" of the hospital from Essent CT and a reconversion of the facility to non-profit form to preserve access to hospital care for this rural area of Connecticut and New York. Section 1.4 of the proposed By-Laws of SACHF recites this intention in Subsection A:

In each of years One through Five, [SACHF] shall not expend or deplete more than 5% of its total assets. After year Five, there shall be no limitation, other than those imposed herein, by the Corporation's Certificate of Incorporation or by any relevant statute or regulation, on the Corporation's ability to expend or deplete its assets.

The language of subsection A, as currently written, violates Connecticut charities law because it applies the spending restriction indiscriminately to both restricted and unrestricted assets of the conversion foundation. The imposition of different or conflicting restrictions upon donor purpose-restricted charitable funds violates the provisions of the Statute of Charitable Trusts, Conn. Gen. Stat. § 45a-514, and the Statute of Charitable Uses, Conn. Gen. Stat. § 47-2. Therefore, as a condition of approval, the language of Subsection A must be amended as provided in Section VI.

I also note that subsection B further limits the expenditure of funds in years 5 through 10:

In the first ten (10) years of the Corporation's existence, the Corporation's spending policies should include due consideration to the preservation of the Corporation's capital in order to preserve the Corporation's ability to exercise its repurchase option under the Purchase Agreement and the Stockholder Agreement.

Testimony from the Ombudsmen for Sharon Hospital at the Attorney General's hearing supported the view that the most likely period for a resale of the assets of the for-profit Sharon Hospital by Essent CT is in the first three to five years after the conclusion of this transaction. The likelihood of resale was supported by the testimony of Dr. Bradford H. Gray, an expert in non-profit hospital conversions, who testified on behalf of CASSH.

Therefore, the time-period in which it is most critical to restrict the Conversion Foundation's ability to spend the proceeds of the Hospital's sale is the first five years after the sale. This restriction becomes less critical after five years when the possibility of resale is somewhat diminished. As a result, I am concerned about unconditionally restricting the conversion foundation's ability to spend money after the first five years, particularly if significant charitable opportunities in the community arise during that time. Accordingly, as a condition of regulatory approval, I require that section 1.4 of the SACHF By-Laws shall be amended as set forth in Section VI.

5. The Amenia Landfill Liability

The Amenia Landfill is a federal superfund site in Amenia, New York, which, according to the Hospital, is contaminated with PCBs.^{42/} CERCLIS NYD980641559, Docket No.

^{42/} After the close of the evidentiary record, Essent CT submitted written comments that state that the contamination at the landfill include pollutants other than PCB. If true, the Hospital's representations at the evidentiary hearing were misleading at best and suggest that the Hospital's potential exposure is greater than represented. Significantly, Essent CT did not attempt to correct the Hospital's statements on the record or otherwise attempt to clarify the facts surrounding the Amenia Landfill.

02-1999-2022-0001. The Hospital has consistently denied liability for any pollution at the landfill and represents that it has never generated a PCB wastestream.

Section 10.10 of the Asset Purchase Agreement imposes further restrictions related to the Amenia Landfill upon the use of the funds passing to the conversion foundation:

10.10 Agreement Regarding Amenia Landfill. Until the earlier of (a) ten (10) years after the Closing Date, or (b) the final resolution of all potential liability of Seller or Buyer with respect to Seller's use of the landfill located in Amenia, New York, after the payment of all outstanding obligations of Seller, Seller will place (i) the net proceeds of the Purchase Price, and (ii) all other assets of Seller (other than the real property located at 82 Amenia Road) that are not purchased by Buyer hereunder, into an account controlled by the Foundation and that is segregated from other assets of the Foundation. On or before the Closing Date, Seller, Buyer and the Foundation will enter into an agreement (the "Foundation Agreement"), which upon execution will be attached to this Agreement as Exhibit J, and which will provide in part that should the Seller or Buyer be required to pay any remediation costs, settlements or related expenses in connection with the Hospital's prior use of such landfill, the Foundation will pay all such costs, settlements and payments out of the account described above. In addition, until the termination of Seller's obligations in this Section 10.10, the Foundation Agreement will provide that the Foundation will not make grants using more than five percent (5%) of the total assets in such account in any one year.

This provision would require the conversion foundation to expend funds to satisfy any of the Hospital's liability for costs or remediation associated with the Amenia Landfill. Thus, this language in the Asset Purchase Agreement appears to impose an additional restriction upon all of the conversion funds, including both donor-restricted funds and unrestricted funds. Several problems arise from this arrangement.

First, as to restricted funds, it imposes an additional restriction--holding each responsible for payment of potential environmental liabilities--in conflict with the donor's original restriction. As discussed above, this possible action violates well-settled Connecticut charities law.

Second, as to unrestricted conversion funds, the arrangement conflicts with the language of the Conversion Act itself because the statute requires that conversion funds be expended only

for healthcare purposes. Payment of the Hospital's past environment liabilities cannot be construed within the meaning of the statute to be for "healthcare purposes."

Third, as a practical matter, the language of § 10.10 would also negate SACHF's ability to repurchase the hospital, should it be offered for sale, because the money passing to SACHF is not its own to spend until the liability for the landfill case is resolved, up to a maximum of ten years. With the exception of the permitted annual 5% spending on healthcare, the assets passing to SACHF would, in effect, be merely another escrow fund for the payment of Sharon Hospital's liability in the superfund case. This result is contrary to law and cannot be permitted.

Various parties and intervenors argue that the Conversion Act permits the resulting conversion foundation to satisfy the environmental liabilities of the Hospital with unrestricted charitable assets transferred to the conversion foundation. Specifically, they claim that Sharon Hospital, as a charitable entity dedicated to a healthcare mission, could properly use its unrestricted charitable assets to satisfy its environmental liabilities, so that the conversion foundation's payment of the same liabilities should be construed as being for "healthcare purposes" under the Conversion Act. Their contention is insupportable. The most obvious flaw in this argument is that the "exception would swallow the rule", because any liability of the charitable hospital--no matter how far removed from the actual provision of healthcare--could be considered for "healthcare purposes" and thus be transferred to the conversion foundation. This claim, therefore, would blatantly eviscerate the legislature's intent that the funds transferred to the foundation should be actually and directly used for services and programs that prevent illness or treat the sick.^{43/}

^{43/} Essent CT also argues that the Conn. Gen. Stat. § 33-1176 of the Non-Stock Corporation Act requires the parties to transfer the liability to the conversion foundation. Section 33-1176 requires that when a non-stock corporation voluntarily dissolves, the corporation must make adequate provision for its liabilities: "The assets of a [nonstock corporation] in the process of

Essent CT is extremely reluctant to assume the landfill liability because there has been no precise estimate of the potential exposure. This concern, however, is significantly lessened by explicit representations by the Hospital, which Essent has never disputed, that the potential liability for the Amenia Landfill case is extremely small or nonexistent. Indeed, in the November 9, 2001 hearing, representations were made by Sharon Hospital Spokesman Ben Heller that the liability was estimated to be below \$500,000. Essent's lawyers apparently concurred. Regardless of the accuracy of these predictions, the proffered number must be assumed reasonable for purpose of this proceeding. Therefore, as a condition of approval of the proposed sale, I require Essent CT to agree to assume any liability for the Amenia Landfill that exceeds \$1 million. The parties shall delete from the Asset Purchase Agreement any and all provisions that would require that any liability for the landfill to be satisfied from funds transferred to the proposed conversion foundation.

In light of this condition, the parties shall amend the Asset Purchase Agreement so that an additional \$1 million may be placed in escrow to cover liability for the landfill up to that amount. If the liability for the landfill is determined to be less than that amount, the proposed conversion foundation shall receive any amount remaining from the \$1 million after the Hospital's liability has been satisfied. If contributions are made by citizens for this purpose, the \$1 million from Sharon

dissolution shall be applied and distributed as follows: (1) All liabilities and other obligations of the corporation shall be paid, satisfied or discharged, or adequate provision shall be made therefor" Essent CT, however, fails to recognize that there are numerous options to make adequate provision for the liabilities of the Hospital, including, but not limited to, having Essent CT contractually assume them or hold funds in escrow until they can be paid. In fact, with respect to some of the outstanding liabilities, Essent CT and Sharon Hospital have chosen to employ the latter method. Consequently, there is nothing in § 33-1176 that requires that the liabilities be transferred to the conversion foundation. Indeed, the Conversion Act plainly prohibits it.

Hospital shall be reduced by such amounts.^{44/} In any event, the maximum to be taken from such funds shall be \$1 million.

Finally, Essent CT has expressed a willingness to assume the defense costs associated with litigation arising out of the Amenia Landfill case. In light of Essent CT's potential exposure if the liability is greater than \$1 million, I conclude that Essent CT should participate in the defense and settlement of these claims. Accordingly, Essent CT shall provide for the defense of these claims and may draw upon the \$1 million placed in escrow for reimbursement of these defense costs. Essent CT will remain responsible for any liability associated with the landfill that exceeds the amount of the \$1 million or of remaining funds in escrow that are designated for this liability.

6. Changes to the Proposed Tertiary Care Relationship Between Essent CT and St. Francis Hospital

As noted above, Essent CT and St. Francis Hospital and Medical Center have entered into a Tertiary Support Agreement with Essent Healthcare of Connecticut, Inc. for the provision of certain tertiary medical care services and administrative resources at Sharon Hospital should its conversion to for-profit status be approved. St. Francis is organized and operates under the sponsorship of the Roman Catholic Church and conducts its activities in accordance with the Ethical and Religious Directives for Catholic Health Care Services as adopted by the United States Conference of Catholic Bishops. These Directives prevent St. Francis from participating with Essent and Sharon Hospital in a wide variety of obstetrical, gynecological and reproductive services.

Pursuant to the Tertiary Support Agreement, St. Francis has pledged to provide Sharon Hospital tertiary resources as well as advice and assistance on a variety of other management,

^{44/} Very generously, Sharon resident Ben Heller has offered to contribute \$250,000 toward satisfying any liability on the part of the Foundation. This amount may be added to the \$1 million escrow.

administrative, and educational programs, including physician recruitment. The proposed tertiary care relationship is intended by Essent CT and St. Francis to be non-exclusive and does not prevent Sharon Hospital from establishing arrangements with other healthcare providers for tertiary services, including reproductive healthcare and family planning, that are not included among the tertiary services to be provided by St. Francis. Pursuant to the tertiary care agreement, Essent CT and Sharon Hospital will continue to be independent organizations that are not under the control of St. Francis.

Significant and understandable concerns have been raised by certain of the intervening parties, as well as members of the public, regarding the impact of the tertiary care relationship on the availability of reproductive healthcare services in the Greater Sharon community. These concerns focus on the ability of Sharon Hospital to continue to provide these services because of the possible application of the Catholic Directives to Sharon Hospital. In addition to the concerns about reproductive healthcare issues, significant questions have also been raised regarding the potential impact or limitation on "end-of life" care for patients at Sharon Hospital or patients who are referred to St. Francis for tertiary care services.

In light of these concerns, I conducted significant discovery on these issues. Moreover, at the adjudicatory hearing held in this proceeding, I strongly urged Essent CT, Sharon Hospital and the intervenors to resolve these concerns, which they pledged to do.

St. Francis and Essent CT have now agreed to make certain clarifications and amendments to the Tertiary Support Agreement as reflected in a letter from Barry Feldman, counsel to St. Francis, dated August 23, 2001. Moreover, on August 23, 2001, Essent Healthcare, Inc. and Essent CT submitted proposed stipulations to me which they consent to be imposed as modifications to the conversion agreement.

I conclude that in light of these various clarifications, concessions and modifications that the proposed tertiary care relationship will not have a material negative impact on the provision of reproductive or "end-of-life" healthcare services at Sharon Hospital. As a condition of approval of these transactions, I hereby require that the Tertiary Support Agreement be amended to include all of the changes set forth in the August 23, 2001 letter from Attorney Barry Feldman to me, which is hereby attached to this decision as Exhibit B. I also impose as modifications to the proposed transaction the stipulations set forth in an August 23, 2001 letter from Attorney John F. Wolter, counsel for Essent CT, which is hereby attached to this decision as Exhibit C.

These modifications and stipulations reflect two main points. First, all parties intend that Essent CT and Sharon Hospital and their employees will not be bound by the Catholic Directives in any manner in the operation of Sharon Hospital. Second, Essent CT and Sharon Hospital are committed to continuing the full range of reproductive health services currently provided by Sharon Hospital, and to enhance and improve the cost, availability and quality of these services, including entering into additional tertiary care relationships with one or more hospitals.^{45/}

For example, St. Francis and Essent CT have agreed that St. Francis will not provide any physician or medical staff recruitment services to or for Sharon Hospital or Essent CT in the areas of obstetrics, gynecology, pediatrics, family medicine or anesthesiology. St. Francis and Essent CT also have agreed that in performing any recruitment services to or for Essent CT or Sharon Hospital, St. Francis shall not inquire as to the candidates' position or beliefs with respect to the Catholic Directives, nor ask any candidates to conform with the Directives.

St. Francis and Essent CT have agreed that they shall not enter into an agreement in which St. Francis provides pharmacy services to Sharon Hospital or Essent CT unless Sharon Hospital

^{45/} I, of course, recognize that Essent CT's commitments are dependent upon and subject to explicit regulatory oversight by the Commissioner of Healthcare Access.

or Essent CT enters into a separate agreement with a third party for the provision of pharmacy services that includes the ordering, stocking, and dispensing of contraceptives, drugs and other medications necessary for the provision of reproductive health care services at Sharon Hospital.

I impose one further condition for approval of the proposed agreement and sale. Essent CT and Sharon Hospital shall require that any patients of Sharon Hospital who are being referred to another hospital by their admitting physician, or by any staff of Sharon Hospital, be appropriately and fully informed regarding limitations on the scope and range of medical services and end-of -life care available to the patient at the hospital or health care institution. The disclosure shall include a discussion of any limitations on the scope of services created by the institution's secular or religious mission, strategic plan, medical staffing, financial resources and internal ethical policies or directives. Essent CT and Sharon Hospital shall make best efforts to educate its physicians and staff as to their obligations arising from this condition.

I. The Parties to the Transaction Have Provided the Attorney General Sufficient Information and Data to Adequately Evaluate the Proposed Transaction.

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

Despite the erratic, untimely, belated and piecemeal release of pertinent information requested by me, I conclude that the parties to the proposed transaction eventually provided all relevant information and sufficient data to evaluate adequately the proposed transaction. The delays and resistance in production unnecessarily lengthened the review process. Difficulties with

the timely production of certain information may be attributed in part to the fact that the present transaction involves the first application of the hospital conversion statute. Still, these delays had consequences: Sharon Hospital was forced to spend precious charitable resources on transactional expenses and costs unnecessarily incurred as a result of these delays.

VI. MODIFICATIONS

Accordingly, pursuant to the responsibility vested in me by Conn. Gen. Stat. § 19a-486b(b), I hereby approve the proposed sale conditioned on the following modifications:

A. Prohibition Against Cross-Collateralization of Sharon Hospital's Assets

Essent Healthcare, Inc. shall modify its Loan Agreement with Heller to expressly prohibit the cross-collateralization by Essent CT or Essent Healthcare of Sharon Hospital's assets, including the Hospital's accounts receivable. As a condition of approval, the Loan Agreement with Heller must be modified to state *unequivocally* that Sharon Hospital's assets, including its accounts receivable, will be used as collateral only for those funds that will be advanced to Sharon Hospital, and only Sharon Hospital, for any purpose whatsoever, including working capital.

Essent CT shall submit to me, within forty-five days of the issuance of a final decision in this proceeding, a draft Amended Loan Agreement with Heller containing the required modifications. After review and approval, Essent CT shall submit to me the executed modified Loan Agreement with Heller as a condition of approval of the proposed transaction.

Essent CT and Essent Healthcare are prohibited from entering into any other financing agreement in which assets of Sharon Hospital may be used as collateral for borrowing funds to be used for any projects unrelated to Sharon Hospital. None of the justifications advanced for eliminating this provision have been supported by specific facts -- such as the supposed savings in

expenses. Cross-collateralization would inexcusably place Sharon Hospital in potential peril. This practice cannot be countenanced.

B. Prohibition Against Debt Financing of Purchase Price

Representatives from Essent CT have stated that, given the Hospital's continuing and projected losses for fiscal year 2001, Essent CT now believes that the Hospital would be "strengthened" if Essent CT used 100% equity financing for the purchase price of the Hospital. This intention by Essent CT is further evidenced by a Resolution executed by Essent Healthcare's Board of Directors authorizing the directors of Essent CT to "take all necessary steps to utilize equity funding obtained under the provisions of the Purchase Agreement dated as of March 19, 1999 among [Essent Healthcare], Thoma Cressey Fund VI, L.P., Thoma Cressey Friends Fund VI, L.P. and Bryan Cressey in funding all of the Purchase Price (as defined in the Asset Purchase Agreement), other than the portion of the Purchase Price allocated to Adjusted Working Capital (as defined in the Asset Purchase Agreement); . . ." Essent Healthcare, Action Taken on Written Consent by the Board of Directors, August 28, 2001. (Emphasis added).

I strongly support Essent CT's intent to finance the Hospital's purchase price with 100% equity financing. Such a financing arrangement will liberate Sharon Hospital from burdensome and costly debt servicing in the future. Additionally, as Mr. Connery pointed out in the public hearing, financing the purchase price entirely with equity financing will have the less tangible effect of significantly reducing the psychological burden on the Hospital's medical and administrative staff caused by debt currently borne by the Hospital. The proposed equity financing of the purchase price will significantly reduce these burdens on Sharon Hospital and its talented staff.

To ensure that Essent CT's intentions regarding equity financing are implemented, and to realize the positive effects on Sharon Hospital and its staff, I require, as a condition of approval of the proposed transaction, that Essent CT finance all of the purchase price (as defined in the Asset Purchase Agreement), other than the portion of the Purchase Price allocated to Adjusted Working Capital (as defined in the Asset Purchase Agreement), with 100% equity financing.

C. Restriction of Future Sale by Essent CT and/or Essent Healthcare

Serious concerns have been raised about the possibility that Essent CT will own and operate Sharon Hospital for only a short period of time before it decides to transfer the Hospital to a third party purchaser. The concerns arise primarily from the fact that many of the terms of the Asset Purchase Agreement favorable to the Hospital--and the community--will not necessarily bind a subsequent purchaser of the Hospital. Specifically, there is genuine concern that Essent CT's commitment to spend at least \$8 million dollars of capital expenditures for improvements to the Hospital in the five (5) years after the close of the transaction will not be honored by a subsequent purchaser of the Hospital should that transfer occur within the first five years of Essent CT's ownership of Sharon Hospital.

To address that legitimate concern, as a further condition of approval of the proposed transaction, the Attorney General's Office unconditionally prohibits Essent CT from selling, leasing or otherwise transferring ownership and/or control of Sharon Hospital to a third party within the first three years from the date of the completion of the sale.^{46/} Essent CT is also

^{46/} Essent CT argues that this condition is not warranted because it may be "misconstrued by the financial marketplace and make it difficult for Essent to obtain additional capital" These assertions are not persuasive because Essent has consistently represented that it plans to own and operate the Hospital for at some substantial period of time. Consequently, a modification formalizing that intention is not unreasonable. Additionally, Essent CT has repeatedly argued that this transaction should be approved in light of its strong financial backing from Thoma Cressey. Its ability to raise capital will not be impacted by the imposition of this condition, assuming that it is representing, in good faith, the expected sources of future financing.

prohibited from selling, leasing or otherwise transferring ownership and/or control of Sharon Hospital within the fourth or fifth year after the completion of the proposed transaction unless it establishes to the satisfaction of the Attorney General that it has made capital expenditures in Sharon Hospital in an amount not less than \$8 million dollars.

D. Profit-Sharing with the Proposed Conversion Foundation

I am also greatly troubled by the fact that the actual amount of funds to be transferred to the conversion foundation may be inadequate for the conversion foundation to exercise its right of repurchase if Essent CT decides to sell Sharon Hospital to a third party. This prospect is made even more problematic if a subsequent purchaser of Sharon Hospital is another for-profit entity because the new purchaser will not be subject to the same regulatory oversight as is Essent CT in this proposed transaction.

Additionally, I am significantly concerned that the proposed conversion foundation will not receive enough funds to serve the important charitable missions to which it will be dedicated. My concern is even more heightened in this proceeding because the Hospital and Essent CT have repeatedly overstated to the public the amount of charitable assets that will be transferred to the conversion foundation. The conversion foundation must have adequate resources to fulfill its mandate of providing vital health care services to the Greater Sharon community, particularly for the community's neediest individuals.

Accordingly, I impose as a condition of my approval of the Hospital's application that Essent CT agree to share with the proposed conversion foundation all net earnings^{47/} in the following amounts during the first ten years after the closing of the sale of the Hospital to Essent

^{47/} The term "net earnings" must be construed in accordance with generally accepted accounting principles as set forth by the Financial Accounting Standards Board.

CT: If the net earnings of Essent CT exceed 7% per annum of total revenues, twenty-five percent (25%) of the amount of net earnings in excess of 7% of total revenues, as based upon and determined by the report of an independent auditor, shall be transferred to the conversion foundation at the end of Essent CT's fiscal year.

Essent CT objects, at least in part, to this condition. Essent CT's objection is premised primarily on the erroneous assumption that it is already paying a \$4 million premium over the fair market value of the Hospital for the Hospital's assets. This premise is false. As I noted elsewhere in this decision, the best evidence in this case of the fair market value of the Hospital's assets is the actual \$16.39 million that Essent CT has agreed to pay since as a willing buyer purchasing the Hospital from a willing seller in an open and competitive market. In light of this fact, I conclude that the profit sharing condition is necessary to help ensure the validity of Essent CT's promises contained in the Asset Purchase Agreement that the proposed conversion foundation have a realistic opportunity to repurchase the Hospital if Essent CT decides to sell it within the first ten years.

For purposes of reporting and projecting the amount of net earnings available for profit-sharing, Essent CT shall supply to the Attorney General every six months a copy of the "Summary of Revenue and Expense," Hospital Budget System Form 300, submitted to the Office of Healthcare Access, or such similar or amended form as the Commissioner of the Office of Healthcare Access may require of for-profit hospitals operating in the State of Connecticut.

For the purpose of determining net earnings subject to profit-sharing, during the first five years after the closing of the sale, Essent CT shall submit to the Attorney General a copy of all audit reports of the independent auditors required by the Commissioner of the Office of Healthcare Access under modifications No. 5 and 6 of his decision in this case. Among the

reports required of the independent auditors shall be a determination of the annual net earnings figure and the dollar amount passing to SACHF as a result of this profit-sharing provision. In years six through ten after the closing of the sale, Essent CT shall continue to maintain the auditing requirements set out in modifications No. 5 and 6 of the Commissioner's decision.

The auditing and profit-sharing provisions set out in this modification shall survive any sale of the hospital and pass to any subsequent for-profit purchaser of Sharon Hospital and Essent CT or its assets during the ten year period after the closing of this sale.^{48/}

E. Strengthening the Advisory Board

As noted above, the Board succeeded in negotiating several important terms with Essent Healthcare prior to the execution of the Asset Purchase Agreement. Among these important terms is a requirement that Essent CT agree to establish an Advisory Board of Trustees if it obtains all regulatory approvals for the sale of the Hospital. Recognizing the need for the community to retain a voice in the operation of a for-profit Sharon Hospital, the Hospital and Essent CT envisioned the Advisory Board of Trustees as a vehicle for the community to have a meaningful voice in the management, quality of service and overall strategic direction of the for-profit Sharon Hospital. The Board's concerns in this regard should be supported, and, indeed, the Board should be commended for seeking to ensure that the community retains some control over what has been and will continue to be a precious resource.

Valid concerns have been raised as to whether the Advisory Board will have real and meaningful input into the management of Sharon Hospital, because Essent CT is under no obligation to follow the advice and guidance of the Advisory Board as it manages the Hospital. These arguments are based on the provision establishing the Advisory Board, which simply states

^{48/}

that Essent CT "will seek the input of the Advisory Board." The language is silent as to what weight, if any, Essent CT will give this "input" from the Advisory Board. In the absence of any provision mandating stronger accountability by Essent CT to the Advisory Board, valid issues raised by the Advisory Board may be dismissed without real consideration by Essent CT. My firm belief is that the Advisory Board will not fulfill its intended highly important purpose unless it is strengthened.

To that end, and as a further condition of approval of the proposed transaction, the Attorney General requires that Section 7.7 of the Asset Purchase Agreement be amended as follows:

"Advisory Board of Trustees. Buyer will create an Advisory Board of Trustees comprised of community representatives and physicians on the medical staff of the Hospital. The Advisory Board of Trustees shall consist of no fewer than nine (9) members and shall be so constituted that:

(1) At least three members of the Board shall be elected public officials currently holding office in the Hospital's primary service area, or their designees;

(2) At least three members shall be members of the medical staff of Sharon Hospital; and,

(3) At least three members shall be nominated and selected by the elected public officials or their designees serving on the Advisory Board.^{49/}

(4) Essent CT may select two additional members beyond the nine set forth above.

^{49/} Essent CT objects to this selection of this category of board members, asserting that these three board members should be chosen by Essent CT itself. I reject this proposal because the fundamental purpose of this advisory board is to ensure that Essent CT listen to the voices in the community that are objective and independent of Essent CT. There simply would be no purpose served by a board constituted by Essent CT representatives who in effect tell Essent CT what it would like to hear.

"The Buyer shall meet with the Advisory Board at least quarterly and will seek input of the Advisory Board of Trustees with respect to various decisions affecting the Hospital, including but not limited to, management evaluations, monitoring of clinical quality at the Hospital and the overall strategic direction of the Hospital. The Advisory Board of Trustees shall establish procedures to assure maximum feasible participation in the operation, scope of services and overall strategic direction of Sharon Hospital.

"The Buyer agrees to consult with the Advisory Board prior to implementing material changes in the operation and management of Sharon Hospital. Buyer further agrees to consider and implement, as warranted, considerations by the Advisory Board of Trustees. All recommendations to Buyer by the Advisory Board of Trustees shall be in writing and shall be retained by the Buyer for inspection by members of the public upon written notice to the Buyer."

"The Buyer expressly agrees to include the provisions contained in Section 7.7 of the Asset Purchase Agreement regarding the Advisory Board of Trustees as a covenant to any agreement for the sale, lease or otherwise transfer of control of Sharon Hospital to a third party purchaser. The Advisory Board of Trustees, as set forth above, shall be amended only by the Attorney General. Essent CT may propose to the Attorney General suggested changes to the structure of the Advisory Board when it believes such changes are warranted."

Essent CT and the Hospital shall submit to me an Amended Purchase Agreement reflecting these changes within 45 days of the issuance of a final decision in this matter.

F. Appointment of Independent Forensic Accountant

The Hospital and Essent CT agree to submit, at the time of the closing, to a review by an independent forensic accountant, chosen by the Attorney General, in order to ensure that all money required to be transferred to the conversion foundation pursuant to the Asset Purchase

Agreement is in fact transferred. The cost for the services of this independent forensic accountant shall be borne by Essent CT.

Sharon Hospital and Essent CT shall make available to the forensic accountant any information he deems necessary to conduct this review. Within three weeks after the date of the closing, the forensic accountant shall report to the Attorney General and the parties the amount of net proceeds to be transferred to the proposed conversion foundation based upon his calculation using the Adjusted Working Capital formula contained in the Asset Purchase Agreement. Essent CT and the Hospital must agree to be bound by any changes made by the forensic accountant to the amount of net proceeds to be transferred. The parties, within one week of issuance of the report of the forensic auditor, shall adjust the final closing figures in accordance with his report.

G. Required Changes to the Escrow Agreement

Within forty five days after issuance of the final decision in this proceeding, Sharon Hospital and Essent CT shall submit to me an amended Escrow Agreement (Exhibit A to the Asset Purchase Agreement) that explicitly provides that any funds remaining in the escrow fund at its termination shall be payable to the conversion foundation approved by the Superior Court to hold such funds.

Within forty five days after issuance of the final decision in this proceeding, Sharon Hospital and Essent CT shall submit to me an amended Escrow Agreement that includes a requirement that Essent CT notify the Attorney General prior to exercising its option to prevent the Escrow Agent from releasing to the proposed conversion foundation the escrow balance, if any, after the expiration of eighteen (18) months from the Closing Date. The required modification is sought in order to prevent the unreasonable withholding of funds past the termination date of the Escrow Fund.

Currently, Section 5 of the Escrow Agreement states, in part: "If, at the time of the termination of the Escrow Fund, Essent shall instruct the Escrow Agent that an amount is being retained in the Escrow Fund to satisfy pending claims, Open Cost Reports and/or Specified Liabilities, such amount shall continue to constitute the Escrow Fund and shall be governed by the terms hereof until such time as the claim is resolved, at which time it shall be paid and distributed by the Escrow Agent to the party or parties entitled to such Escrow Funds pursuant to Section 4."

This provision, as drafted, would permit Essent CT to instruct the Escrow Agent not to release to the conversion foundation the escrow balance at the termination of the specified period of eighteen (18) months after the Closing Date. Conceivably, Essent could withhold these funds beyond the specified eighteen (18) months for any reason or no reason at all, while remaining in conformity with the Agreement. Although I do not intend to imply that Essent CT will retain these fund without reasonable cause, given the fact that the amount of the escrow balance, if any, will ultimately be turned over to the successor foundation, it is imperative that the provisions of the Agreement be amended in order to ensure that these funds are properly accounted for and transferred to the resulting foundation without unreasonable delay.^{50/}

Consequently, as a condition of approval of the proposed transaction, I require that the last sentence of Section 5 of the Escrow Agreement be amended to read:

"If, at the time of the termination of the Escrow Fund, Essent shall instruct the Escrow Agent that an amount is being retained in the Escrow Fund to satisfy pending claims, Open Cost Reports and/or Specified Liabilities, such amount shall continue to constitute the Escrow Fund and shall be governed by the terms hereof until such time as the claim is resolved, at which time it shall be paid and distributed by the Escrow Agent to the party or parties entitled to such Escrow

^{50/} By imposing these changes to the escrow agreement, I do not intend to alter the purposes or categories of claims that may be paid under the escrow agreement, with the exception of provisions for resolution of liabilities arising out of the Amenia Landfill case.

Funds pursuant to Section 4; provided, that, in recognition of his duties under Conn. Gen. Stat. § 3-125 and the common law to represent the public interest in the proper disposition of charitable funds, Essent CT shall first notify the Attorney General of the nature and amount of the claim in dispute and the Attorney General shall participate in all of efforts to resolve the disputed claim including his participation in any court proceeding regarding the claim."

Additionally, forty five days after issuance of the final decision in this proceeding, Sharon Hospital and Essent CT shall submit to me an amended Escrow Agreement (Exhibit A to the Asset Purchase Agreement) that includes, in addition to the language set forth above, the requirement that Essent provide the Attorney General a detailed accounting of all funds expended from the Escrow Funds. The Escrow Agreement must be amended to mandate that the accounting be provided by Essent to the Attorney General every three (3) months so long as the Escrow Fund is in existence; provided, however, that in the event the Attorney General approves a request by Essent to instruct the Escrow Agent to withhold the transfer of funds in escrow beyond the specified eighteen (18) months, then the amended Escrow Agreement must also include a provision whereby Essent will provide the Attorney General with a final accounting of all funds, including all interest earned thereon, in the Escrow Fund.

H. Essent CT shall assume a portion of the hospital's liability, if any, for costs associated with the Amenia Landfill

Within forty-five days of the issuance of the final decision in this matter, the Hospital and Essent CT shall amend the Asset Purchase Agreement to provide that Essent CT shall assume any liability for the Amenia Landfill case, CERCLIS NYD980641559, Docket No. 02-1999-2022-0001, that exceeds \$1 million. Essent CT and Sharon Hospital shall delete from the Asset Purchase Agreement any and all provisions that would require that any liability for the landfill be satisfied from funds transferred to the proposed conversion foundation.

The parties shall also amend the Asset Purchase Agreement to provide that a maximum additional \$1 million is placed in the escrow fund established by the Escrow Agreement (Exhibit A to Asset Purchase Agreement) to cover liability for the landfill up to that amount. Such amount shall be supplemented by the amount of any private contributions made to cover such costs. If the liability for the landfill is determined to be less than \$1 million, the proposed conversion foundation shall receive any amount remaining from the \$1 million after the Hospital's liability has been satisfied.

Finally, Essent CT has expressed a willingness to assume the defense costs associated with litigation arising out of the Amenia Landfill case. In light of Essent CT's potential exposure pursuant to this modification if the liability is greater than \$1 million, I conclude that Essent CT should participate in the defense and settlement of these claims. Accordingly, Essent CT shall provide for the defense of these claims but may draw upon the \$1 million placed in escrow for reimbursement of these defense costs; provided that Essent CT remains responsible for any liability associated with the landfill that exceeds the amount of remaining funds in escrow that are earmarked for this liability.

I. Required Changes to the Tertiary Support Agreement

Within forty-five days of the issuance of a final decision in this proceeding, Essent CT and St. Francis Hospital shall submit to me a revised Tertiary Support Agreement reflecting the agreed upon changes to the Tertiary Support Agreement, as set forth in the letter from Attorney Barry Feldman to Attorney General Richard Blumenthal, dated August 23, 2001. (Attached hereto as Exhibit B).

As a condition of approval of the proposed transaction, Essent CT and Essent Healthcare shall comply with the stipulations set forth in the August 23, 2001 letter from Attorney John F. Wolter to Assistant Attorney General Eliot D. Prescott. (Attached hereto as Exhibit C).

Additionally, Essent CT and Sharon Hospital shall require that any patients of Sharon Hospital who are being referred to another hospital by their admitting physician, or by any staff of Sharon Hospital, be appropriately and fully informed regarding limitations on the scope and range of medical services and "end-of-life care" available to the patient at the hospital or health care institution to which the patient is referred. The disclosure shall include a discussion of any limitations on the scope of services created by the institution's secular or religious mission, strategic plan, medical staffing, financial resources and internal ethical policies or directives. Essent CT and Sharon Hospital shall make best efforts to educate its physicians and staff as to their obligations arising from this condition.

J. Required Changes to the Hospital's Gift Analysis

In order to provide the resulting conversion foundation with an accurate accounting of all gifts and trusts to be transferred, along with an appropriate legal classification of such gifts as either unrestricted or donor restricted, Sharon Hospital and Essent CT shall submit to me within forty-five days of the issuance of the final decision a revised Gift Analysis and Funds Value Report to reflect the adjustments set forth below:

1. Restricted endowment funds shall include the \$22,375 in proceeds from the Harriette Harrison Estate, which shall be treated and classified as a free bed fund, and adjusted upwards to \$299,699.00.

2. The historic dollar value of the principal of unrestricted endowment funds held by the Hospital shall be adjusted upwards to \$1,064,129 to reflect the receipt of \$10,000 of principal from the Slater estate.

3. An additional \$25,357 relating to certain charitable gifts for which wills and other gift instruments have been lost, or never located by counsel in the process of the review of charitable gifts and endowments shall be treated as fully expended.

4. The Hospital shall adjust its classification of the following gifts in its Gifts Analysis to categorize them as restricted donations: Benjamin M. Belcher (Tab 35), Rosa DeMuseum (Tab 59), Katharine Eberle (Tab 63), Marjorie Elting (Tab 66), Bedelia Croly Falls (Tab 68), Herbert Fransioli (Tab 74), Jane C. Gillette (Tab 2), Harriette Harrison (Tab 11), Charlotte Miner (Tab 129), Peter Ompir (Tab 138), Theodore Ryan (Tab 153), Lola Sherman (Tab 20), Mary Triacca (Tab 174). Appropriate changes shall be made on its records and in all documents passing any of these funds to SACHF.

5. With respect to the treatment of certain funds as free beds the Hospital shall classify the Harriette Harrison Fund (Tab 11), and the income from the Bedelia Croly Falls Trust (Tab 68) as free beds funds on its records and in all documents passing the funds to SACHF.

6. The Hospital shall adjust upwards the balance of the Margaret H. Williams Fund, a free bed fund, to reflect the actual amount in the separately invested and restricted account to \$375,560.58, the amount actually in that account as of May 31, 2001. In addition, the Hospital shall adjust upward the total 2001 Balance line item on the Hospital's Funds Value Report by \$228,987.36 and the calculation of the charitable funds held and administered by the Hospital by the same amount to \$12,983,722.00.

7. The Hospital shall deduct the line item on its Sources and Uses Table to remove the \$6,501,116.00 encaptioned "Amounts Held in Trust by Others," representing the principal of the I. Kent Fulton Trust and the William G. and Mary C. Raynsford Trust Fund held and administered on an ongoing basis its trustee, Fleet Bank N.A.

8. The Hospital shall refrain from holding out to the public, or adding to any documents that may be part of the transfer of funds to SACHF, all references to the transfer of the principal of the Bedelia Croly Falls Trust to SACHF, since that fund will be held and administered on an ongoing basis by its cotrustees, The Trust Company of the Berkshires, and Attorney Mark C. Capecelatro.

9. The Hospital shall delete from any transactional documents that may be part of the transfer of funds to SACHF, all references to the transfer of the income interest in the William G. and Mary C. Raynsford Trust Fund, which is governed by the donor's gift-over provisions that permit the trustee to select two or more charitable organizations in Salisbury to receive the gift if Sharon Hospital ceases to exist as a charitable institution.

10. The Hospital shall delete from the transactional documents all references to the transfer of the income interest in the Clark Weed Trust Fund, which is governed by the donor's gift-over provisions providing that if Sharon Hospital ever ceases to exist as a charitable institution at any time or for any reason, the fund is to be transferred to the Newington Home for Crippled Children (now the Connecticut Children's Medical Center).

11. The Hospital shall refrain from representing that the gift from the Hazel M. Peck Estate will pass to the conversion foundation, since the timing of the final accounting and order of distribution of assets from that estate will determine whether Sharon Hospital Inc. will receive a distribution in time to pass it to SACHF.

12. The Hospital shall not represent in any of the transactional documents that the following vested future interests, which have not yet ripened into enjoyment, in the following charitable remainder trusts and charitable remainder unitrusts will pass to the conversion foundation from the Hospital, since the ultimate decision about the disposition of each such fund will be determined by a court of competent jurisdiction after the death of the last named life beneficiary on a case by case basis: Richard H. Emerson (Tab 67), Mary W. Howard (Tab 99), Hazel M. Peck (Tab 141-A), Florence C. Scheller (Tab 155), and Archibald Talmage (Tab 170).

13. The Hospital shall include the \$133,276.23 of funds raised and held by the Sharon Hospital Auxiliary among the charitable gifts passing to SACHF, and such funds shall be treated by the conversion foundation as unrestricted gifts.

K. Sale of the Nursing Home

Within forty-five days after the issuance of the final decision in this proceeding, Sharon Hospital shall submit to me an amended sales contract for the sale of the Nursing Home that contains a novation or addendum executed by Sharon Corporation, Sharon Healthcare Inc. and United Methodist Homes, Inc. that clarifies and confirms that the net proceeds of the sale of the Nursing Home and the remainder of the escrowed "Risk Fund" will pass to SACHF. The language of such novation or addendum shall state that all net proceeds of the sale of the Nursing Home, plus any interest that has accrued thereon, will pass to the conversion foundation approved by the Superior Court at the closing of the sale of the Hospital to Essent CT. In addition, the escrowed money in the Risk Fund will pass to the conversion foundation at the end of the five year contractual escrow period.

In addition, as a condition of approval, the Hospital and/or Sharon Corporation shall provide to me copies of all closing documents relating to the sale of the Nursing Home, an

accounting of the funds transferring as a result of the transaction, and documents demonstrating the creation of the escrow Risk Fund. Finally, as a condition for approval of the sale of the Hospital, I require on the first six yearly anniversaries of the sale of the Nursing Home, an annual report on the use of all funds held in the Risk Fund, and a statement of fund balances with supporting documents in the form of the monthly or quarterly reports of the account(s) in which the Risk Fund is held.

L. Financial Accounts

Within forty-five days after the issuance of the final decision in this proceeding, Sharon Hospital shall submit to me documentation establishing that, as a result of the 1996 merger of the Sharon Foundation into Sharon Corporation, it has legal title to the accounts containing funds to be conveyed to the resulting conversion foundation. If it does not have legal title to these accounts, it must take all legal steps necessary to ensure the transfer of the funds in said accounts to SACHF.

In addition, the Hospital must submit to me documentation of the sources and charitable purposes of the EMT Fund at Investors Bank & Trust Company, Account No. 020407420104.

M. Margaret H. Williams Fund

Within forty-five days after the issuance of the final decision in this proceeding, Sharon Hospital shall submit to me a full accounting of the Margaret H. Williams Fund from January, 1998 to the present, because the \$375,560.58 balance in the above account on May 31, 2001, and the \$143,559 on the Funds Value Report of the identical date do not reconcile.

N. Berkshire Taconic Community Foundation and the Sharon Area Community Healthcare Foundation

Within ninety days after the issuance of the final decision in this proceeding, BTCF shall submit to me a list of the names of the proposed board members of SACHF. The Attorney

General may disapprove any board member if he determines, in his sole discretion, that the proposed board member is affiliated through corporate structure, governance or membership with either the non-profit hospital or the purchaser or serves or is proposed to serve on the for-profit Hospital's community advisory board.

Within forty-five days of the issuance of the final decision in this proceeding, Sharon Hospital or BTCF shall submit to me an amended draft certificate of incorporation for SACHF that explicitly prohibits its board members from serving on the community advisory board of trustees proposed by Essent to consult in the "management, clinical quality monitoring and strategic planning" at Sharon Hospital when it converts to for-profit form.

Within forty-five days of the issuance of the final decision in this proceeding, Sharon Hospital or BTCF shall submit to me an amended Section 2(a)(i) of SACHF's draft Certificate of Incorporation that explicitly provides that the SACHF board may invest in the acquisition of all or part of the acute care hospital facilities and operations of Sharon Hospital **solely** for the purpose of reconverting the hospital to a non-profit form and that the board may not use the conversion foundation funds to purchase or invest in Sharon Hospital if it is operating in a for-profit form.

Within forty-five days of the issuance of the final decision in this proceeding, Sharon Hospital or BTCF shall submit to me an amended draft Certificate of Incorporation of SACHF that omits all references to BTCF as a **member** of SACHF and that provides that the corporation shall be formed as a non-stock, **non-membership** corporation with a self-perpetuating board of directors, which will manage and exercise the powers of the corporation. The amended draft certificate of incorporation shall provide that the number of directors on the SACHF board is to be uneven in number, and no fewer than 11, but no more than 17 members, with staggered terms

as proposed in the draft By-Laws Section 3.3. No more than three seats on the board of SACHF shall be filled by members of the board of BTCF

Within forty-five days of the issuance of the final decision in this proceeding, Sharon Hospital or BTCF shall submit to me an amended draft Certificate of Incorporation that provides, upon dissolution of SACHF, after payment or making provision for the payment of all of its liabilities, and after notice to me, all of its remaining assets shall pass to one or more organizations that are to be selected by the Superior Court, and which are organized and operated exclusively for charitable healthcare purposes and that qualify as tax exempt organizations under Section 501(c)(3) of the Internal Revenue Code.

Within forty-five days of the issuance of the final decision in this proceeding, Sharon Hospital or BTCF shall submit to me an amended draft Certificate of Incorporation that provides that any modification to Article 2 of the certificate of incorporation that alters, expands, or contracts SACHF's stated corporate purposes must receive prior written approval by the Attorney General, and, if necessary, additional approval by the Superior Court.

Within forty-five days of the issuance of the final decision in this proceeding, Sharon Hospital or BTCF shall submit to me an amended Subsection A of Section 1.4 of the proposed By-Laws of SACHF that reads:

In each of years One through Five, the Corporation shall not expend or deplete more than 5% of its unrestricted assets, which include: charitable gifts deemed unrestricted and fully expendable by the Attorney General, the unrestricted income earned on trust funds held by others, those "institutional funds" held by SACHF as defined by the Connecticut Uniform Management of Institutional Funds Act, Conn. Gen. Stat. § 45a-527(2) which contain no donor restrictions on the use of income, the Auxiliary Funds, the Net Transaction Proceeds of the hospital sale, the proceeds of the sale of the Nursing Home to United Methodist Homes, Inc., and all funds that may pass to SACHF from the distribution of escrow accounts arising from either of the aforementioned transactions. The provisions of this Subsection

shall not apply to any donor-restricted funds received by SAHCF from the above transactions or from subsequent donor-restricted gifts.

Within forty-five days of the issuance of the final decision in this proceeding, Sharon Hospital or BTCH shall submit to me an amended Subsection B of Section 1.4 of the proposed By-Laws of SACHF that reads:

In each of years Six through Ten of the Corporation's existence the Corporation's spending policies may include consideration of the preservation of its unrestricted funds in order to protect the Corporation's ability to exercise its repurchase option under the Purchase Agreement and the Stockholder Agreement; provided however, that if at any time in years Six through Ten a 3/4 majority of the Board of Directors of SACHF determines that SACHF should fund one or more worthy healthcare projects, the cost of which, individually or collectively, exceeds the 5% spending cap set out in Section 1.4 A of these By-Laws, the board may vote to override said spending cap by a vote of 3/4 of its members.

RICHARD BLUMENTHAL
ATTORNEY GENERAL