PROSPECT MEDICAL HOLDINGS, INC.

3415 South Sepulveda Boulevard
9th Floor
Los Angeles, CA 90034
Tel (310) 943-4500
Fax (310) 943-4501

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Fernanda Lopes, MPH, Chief
Office of Health Systems Development
Department of Health
Three Capitol Hill, Room 410
Providence, RI 02908

Jessica Rider, Health Care Advocate
Special Assistant to the Attorney General
Office of the Attorney General
150 South Main Street
Providence, RI 02903

Dear Ms. Lopes and Ms. Rider,

Like each of you, Prospect Medical Holdings takes very seriously its responsibility to provide essential healthcare in the communities it serves.

We are aware of the letter you received from the Private Equity Stakeholder Project (PESP). Similar letters have been written by PESP to Representative David Cicilline, among others.[1] As you will see below, the letter is replete with errors.[2]

Here are the facts:

Since 2010, when Leonard Green & Partners (LGP) invested in Prospect, the company has grown from five hospitals with 759 licensed beds and approximately 2,100 employees to 17 hospitals with 3,300 licensed beds and approximately 16,800 employees. Prospect has invested hundreds of millions of dollars to acquire and improve the operations of hospitals, many of which had been on the verge of closure prior to being acquired by Prospect. These acquisitions have improved the operations of such hospitals and made many positive contributions to the communities they serve, including improving access to healthcare and the addition or preservation of jobs at the hospitals Prospect has acquired.

[1] Much of the information contained in this letter was also provided in a letter by Leonard Green Partners to Rep. Cicilline.

[2] Not disclosed in the PESP letter is that, as public documents show, Jim Baker, one its signatories, is a registered lobbyist.

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The CharterCARE hospital system in Rhode Island, which Prospect purchased in June 2014, is an example of a failing hospital system that would have likely been forced to close had it not been acquired by Prospect. The hospitals that were part of the system had been in serious financial trouble for years prior to their acquisition by Prospect. The situation was sufficiently dire that CharterCARE began seeking alternatives "*to ensure the continued viability*" of the CharterCARE hospitals[3] in December 2011. To provide you a sense of just how serious those financial issues were, CharterCARE incurred a $9 million loss in the six-month period ending in March 2014, before being acquired by Prospect. Ultimately, the financial situation at CharterCARE became so grave that the management and the board of the hospital attested that "*The system does not have the ability to survive long-term with a 'go it alone' strategy*."[4] CharterCARE was in urgent need of a lifeline, which Prospect provided.

Since that time, Prospect has revitalized CharterCARE with investments in a new ambulatory surgery center, a new long-term behavioral care program, new suboxone clinics and new physician groups. Additionally, Prospect has expanded CharterCARE's emergency department at Roger Williams, its Level 4 inpatient addiction medicine program, and its primary care physician base.

North Providence, Rhode Island Mayor Charles Lombardi commented, "Prospect's investment saved thousands of jobs at both Fatima and Roger Williams, generated tax revenue for our community and most certainly stimulated our local business economy."[4] In fact, Prospect has paid nearly $25 million in state and local property and sales use taxes to support local communities that would not have been available under prior ownership.

Today, CharterCARE's hospitals are 5-star rated by Healthgrades for outcomes in numerous conditions and procedures including heart failure, heart attack, total knee replacement, stroke, chronic obstructive pulmonary disease, pneumonia, appendectomy, sepsis and respiratory failure. Brad Bowman, MD, Healthgrades Chief Medical Officer, said "This 5-star rating for these conditions and procedures showcases the expertise and commitment of CharterCARE's hospitals to their patients."[5] Furthermore, under Prospect's ownership, the CharterCARE hospitals have gained accredited status for behavioral health services and spine surgery, and its cancer program has achieved accreditation by the American College of Surgery – Commission on Cancer – and has been awarded an outstanding achievement award. Finally, CharterCARE's quality metrics as measured by CMS for surgical complications, infections and mortality have improved since being acquired and benefitting from Prospect's leadership and management.

PESP's letters reference allegations in lawsuits regarding the pension of St. Joseph Health Services of Rhode Island. While Prospect was named in this litigation along with a host of other unaffiliated defendants, Prospect should not have been named as a party to this lawsuit, as the pension

[3] State of Rhode Island Department of the Attorney General, CharterCARE/Prospect Final Decision, Retrieved at: http://www.riag.ri.gov/documents/5-16-14AGFinalDecision.pdf
[4] http://www.CharterCARE.org/news-and-events/post/prospect-delivers-on-promise-with-70-million-of-investments-in-rhode-island added 01.08.2018
[5] http://www.CharterCARE.org/news-and-events/post/CharterCARE-hospitals-receive-5-star-ratings-in-numerous-clinical-outcomes

obligations under dispute were and remain the responsibility of the previous owner of the hospitals, not Prospect. Prospect purchased assets of the failing hospital in 2014, long after the pension plan was in financial distress. The legal agreements associated with Prospect's purchase expressly state that Prospect did not assume responsibility for the pension plan. The transaction as structured was vetted and approved by the Rhode Island Attorney General, the Rhode Island Department of Health and the local hospital unions. Following the 2014 acquisition, employees in Rhode Island were given the opportunity to participate in a new retirement plan Prospect offered to its employees; that plan is today continuing to operate effectively, and in a financial responsible manner. Finally, all issues raised in the pension litigation will be decided in the federal district court action.

PESP's letters and report also include misrepresentations about Prospect's debt.

What is true is that Leonard Green & Partners ("LGP") invested in Prospect through a going-private transaction. Zero additional debt was incurred as a result of the transaction. Rather, it was funded entirely with equity from institutional investors for whom LGP manages capital; the group is predominantly comprised of public and corporate pension funds, and endowments and foundations, including several state pension funds that provide retirement benefits to millions of public employees including teachers, firefighters, and other first responders.[6]

LGP acknowledges that the investment in Prospect has produced attractive returns for the many beneficiaries and rejects any implication that LGP managed Prospect in a financially irresponsible manner. Contrary to PESP's assertions, Prospect today remains extraordinarily well capitalized, faces no material financial challenges, and is at no risk of financial failure. Currently, Prospect has hundreds of millions of dollars of liquidity available to continue to fund operations, invest in improving the hospitals it manages, and continue providing quality care to its patients. It is also essential to note that CharterCARE hospitals are in significantly better financial health now than they were before Prospect's acquisition of the healthcare system.

PESP mischaracterizes the Medical Properties Trust, Inc. ("MPT") transaction. In July of 2019, Prospect completed a $1.55 billion transaction with MPT that allowed the company to repay all of its existing term loan debt. At the time of the transaction, Samuel Lee, CEO of Prospect, said, "In addition to strengthening Prospect financially, having MPT available for long-term capital provides us with a significant and experienced potential source of funding for improvements to our existing facilities as well as for future acquisitions and other growth opportunities. We will intensify our focus and resources in our existing markets – where we can expand and drive more growth – to provide quality, cost-effective, coordinated care through our comprehensive network of hospitals, medical groups, and ancillary facilities."[7] Prospect continues to have sufficient financial resources to serve its patients and communities.

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[6] Definitive Proxy Statement, Prospect Medical Holdings, Inc., November 12, 2010.
https://www.sec.gov/Archives/edgar/data/1063561/000104746910009625/a2200972zdefm14a.htm#dy70701_financing_of_the_merger_and_the_lgp_funds__guarantee

[7] Prospect Medical Holdings, Inc Press Release July 15, 2019.
https://www.businesswire.com/news/home/20190715005786/en/Prospect-Receive-1.55-Billion-Investment-Medical-Properties

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While Moody's did not change its rating outlook as a result of the MPT transaction, they did however note that "*the transaction is credit positive as it will provide a meaningful liquidity boost to Prospect Medical.*"[8] Furthermore, given the retirement of Prospect's debt, Moody's discontinued its ratings of the company in September 2019 and thus has not monitored the continued progress in the company's operations and liquidity position. However, as stated above, Prospect has continued to build liquidity since the MPT transaction and remains well-capitalized.

PESP also makes the assertion that the February 2018 dividend was in violation of representations made to the State of Rhode Island in connection with the approval of Prospect's conversion of the CharterCARE hospitals in Rhode Island from non-profit to for-profit status in 2014. As quoted in its letter, Prospect's management and representatives gave assurances that *"there were no plans to make similar distributions in the foreseeable future."* That was a true statement, and Prospect did not make any distributions until approximately four years after its acquisition. Further, any debt incurred for dividends was repaid in full in conjunction with the transaction with MPT noted above. In addition, contrary to what PESP has claimed in its letter, the February 2018 dividend from Prospect Medical was not paid from Rhode Island hospitals. The CharterCARE entities have not made any cash distributions to its Prospect parent entities or its shareholders. All capital generated at CharterCARE has been retained by CharterCARE to fund operations and to continue to improve the quality of care offered to the communities it serves.

It is also important to note that the dividends referenced in PESP's letter were paid in May 2012, November 2012 and February 2018, long before the current COVID-19 crisis.[9]

The dividends (and note repayment) were fully approved by Prospect's governing leadership and lawfully distributed to all shareholders of Prospect, while only a portion of those amounts were paid to LGP's investor fund. The portion of the dividends paid to the LGP fund was subsequently distributed to its investors, which include the pensions for thousands of public employees in a variety of professions.

Following are other examples of inaccurate and/or misleading statements by PESP:

- PESP's letter states: "This transaction appears to be an effort to insulate Leonard Green & Partners and Prospect's management and the more than $658 million in fees and dividends they have taken from Prospect Medical Holdings from charges of fraudulent conveyance in the event of a bankruptcy by Prospect."
    - Fact: This is not true. A fraudulent change of ownership, if one occurred, which would not be the case here, will <u>not</u> insulate the parties from such a claim. A valid claim for fraudulent conveyance is a claim that may be asserted by unpaid creditors or a bankruptcy trustee, not by the company itself or its shareholders. Prospect

[8] Moody's Investor Services Issuer Comment on Prospect Medical Holdings, Inc. dated July 16, 2019.
[9] The $44 million 2019 dividend noted in your letter was not a dividend to Prospect's shareholders, but rather a repayment of the shareholder capital contribution loaned to the company by way of a note held by our fund and other shareholders.

Medical Holdings and Leonard Green & Partners lack the legal power to extinguish that claim. Under Delaware law, the law applicable to Prospect Medical Holdings, such a claim may be brought any time within four years following a fraudulent conveyance.

- PESP's letter states: "Prospect has also failed to explain why it was appropriate to pay a $457 million dividend to the owners despite representing to the Office of the Attorney General and Department of Health that it would not make pay any more dividends."
  - Fact: As explained above, in 2014, no dividends were planned. Four years later, following multiple hospital acquisitions and expansion into several states, Prospect issued a dividend to its shareholders.

- PESP's letter states: "Leonard Green's sale of its majority stake in Prospect is distinctly a non-arms-length transaction: Leonard Green is both the seller and controls the buyer (Prospect) at the time of the transaction."
  - Fact: This is false. The buyer was not Prospect. The buyers were Samuel Lee and David Topper. This was a transaction between a sophisticated seller and two sophisticated buyers; a transaction that was permissible under the Stockholders Agreement.

- PESP's letter states: "For the year ended September 30, 2019, the $269 million that Prospect claims in the chart as "cash and availability" appears to be largely "availability"—namely the $175 million undrawn balance on Prospect's revolving credit facility, which is not cash."
  - Fact: This is nonsensical. The chart PESP references is not incorrect: it reflects cash <u>and</u> availability. Prospect can borrow the amount up to the amount of the availability and spend it or keep it in cash on its balance sheet, if it so chooses.

- PESP states: After the MPT transaction, Prospect debt terms changed "from LIBOR +5.5% under the loan agreement to 7.5% of the lease base."
  - Fact: This is false by omission and is yet another example of misleading information included in the letter. In fact, Prospect <u>benefited</u> from this change. Throughout the duration of the transaction, 12-month LIBOR ranged from 2.2% to 2.9% and thus the 7.5% rate would have been equivalent, or better than, LIBOR +5.5%.

- PESP states: "The long-term debt Prospect was able to pay off through the MPT transaction was a result of Prospect issuing $1.1 billion new debt in 2018 in part to finance its $457 million dividend to Leonard Green and other owners."

  - Fact: This is incorrect. As stated above, Prospect had an existing $625 million facility that was paid off in 2018 as part of the refinancing. New debt was less than $500 million.

- PESP states: "In May 2019, Prospect East, which owns 85% of the Company, made a non-cash capital contribution in the amount of approximately $24.7 million, which consisted of converting unpaid management fees due to PEHAS of approximately $20.0 million and approximately $4.7 million of unpaid invoices that Prospect paid on behalf of the Company at April 30, 2019, into equity."

  - Fact: Prospect converted management fees ($20mm) that were not paid and unpaid invoices ($4.7mm) into Equity. The invoices were normal operating invoices that PMH paid on behalf of CharterCARE but hadn't yet collected the money. In both instances, PMH forgave the receivable due from CharterCARE which relieved its liability and reclassified to equity characterized as an investment. Whether Prospect received the referenced cash for amounts due for management fees and invoices, then cut a check for the same amount and contributed it back or forgave the amounts (which were a liability owed to them and converted it into equity), is a difference without a distinction. In both instances, the actions by Prospect are explicitly anticipated and allowed for under the APA and LLC Operating Agreement.

- "The characterization of forgiven management fees as a capital expenditure is itself inappropriate. Prospect did not actually contribute anything to Prospect CharterCARE by forgiving the management fees, it merely collected less.

  - Fact: This is False. Section 4.4(a) of the LLC Agreement provides that, with the prior approval of the Board, a member may make capital contributions to the capital of CharterCARE, which would include contributions of capital by the Prospect member to satisfy its Long-Term Capital Commitment, by paying CharterCARE indebtedness or forgiving CharterCARE indebtedness owed to the Prospect member, and such contributions by payment or forgiveness of debt are to be treated as cash contributions.

- PESP states: "Yet as of September 2019, Prospect CharterCARE still reported a year-end management fee liability of $37.96 million, suggesting the management fees were not in fact written off or converted to equity."

  - Fact: This is not true. See Balance Sheet and Statement of Stockholders Equity. There are member contributions of $28mm in FY2019. See note 6 in Consolidated Financial Statements (Audit) per noncash transactions. $24.7 is included in the above reference amount.

We hope the foregoing context and data we've provided is helpful. Please do not hesitate to contact us if you have any questions.

Best regards,

Robert J. Elders
General Counsel