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Windfall Nurses Hospital Feud

HEALTH CARE: Shareholders fight execs over Avanti's money.

By **ALFRED LEE**Monday, June 17, 2013

When Gov. Arnold Schwarzenegger signed a 2009 bill establishing new funds for low-income medical patients, El Segundo hospital chain Avanti Hospitals received a sudden windfall.

But the extra tens of millions of dollars have become the subject of infighting between the company's management and minority shareholders, who claim a few owners are pocketing money that should be reinvested.

The minority shareholders, including the company's biggest individual shareholder and former chief executive, Poe Corn, are fighting for greater access to and control of Avanti. They allege a series of moves by the major principals to enrich themselves at the expense of the company and some of its shareholders.

"It's my belief that operations have suffered while principal shareholders have benefited, all at the expense of patients, taxpayers and minority shareholders," said Michael Linn, an outside investor in the company. "Assets have been stripped from the company and there are less resources available for patient care. And the assets that have been stripped have solely benefited a small number of majority shareholders."

Avanti has not yet responded to the accusations in court. Its general counsel said a cross-complaint was forthcoming.

Avanti, which owns four hospitals in low-income areas of Los Angeles County, has seen two major new sources of money in recent years. One is so-called quality assurance fee funds, a combination of federal Medicaid money and hospital fees that are distributed by the state to hospitals in order to pay for the care of low-income patients. Avanti has received as much as $32 million in such money since the program started in 2010 and is set to receive an additional $24 million this year, altogether representing a hefty operating income boost of 30 percent, according to lawsuits filed by minority shareholders.

The other new source of cash was the sale of the real estate for three of the company's hospitals, which were sold for $86 million last year and are being leased back by the company.

The influx of money has created internal division. Minority shareholders say they have been left out of profit-sharing and that in each case, the company's managing members have distributed some of the money among themselves in the form of bonuses or dividends.

Legal experts said such distributions to certain shareholders would not necessarily be improper, depending on how they worked. The company said that the allegations about pocketing hospital money are incorrect, though it did acknowledge some distributions to members.

"The only distributions from either QAF receipts or other hospital revenue made by Avanti in 2012 were tax distributions, made pursuant to the operating agreement, and distributed equitably among all the members," the company's general counsel said in a statement.

Turnaround company

Avanti was formed by a handful of investors in 2008 to purchase and turn around Memorial Hospital of Gardena and East Los Angeles Doctors Hospital, two underperforming L.A.-area hospitals. The investment team included Joel Freedman, Jamie MacPherson and Nick Orzano of downtown L.A. corporate finance advisory firm Paladin Capital LLC, and Mark Bell and Irv Edwards of Manhattan Beach's Emergent Medical Associates, an emergency room physicians group.

The group was part of a wave of investor-owned hospital chains that saw opportunities in buying up struggling hospitals in low-income areas.

Avanti picked up two other troubled hospitals, Community Hospital of Huntington Park in 2010 and Coast Plaza Hospital in Norwalk in early 2011. That same year, Corn, a former executive vice president at real estate firm Jones Lang LaSalle Inc., was brought in as chief executive. Other minority shareholders, including Linn, an investor from Daytona Beach, Fla., and Vijay Dhawan, a physician at East Los Angeles Doctors Hospital, were also brought in during the first three years.

The company proved successful in turning around its hospitals. The net income of its Gardena and East L.A. hospitals rose to $18 million on $200 million in operating revenue in 2011, up from $4 million on $132 million in operating revenue in 2008, according to state records. Collectively, the net income of the company's four hospitals was $16 million on $249 million in operating revenue in 2011. More than 60 percent of the revenue from three of the company's hospitals came from Medi-Cal and Medicare payments and reimbursements, according to court filings.

At one point, according to Corn's lawsuit, the company was in negotiations to sell itself for as much as $220 million.

But internal conflict hit last year. Corn was ousted as chief executive, after which Freedman took over many executive duties. Late last year, the company executed the sale and lease back of its first three hospitals. But instead of reinvesting the money into the company, minority shareholders claim some of the proceeds went into the pockets of majority shareholders.

Those concerns also extended to the tens of millions of new money, a significant amount of which they believe were also distributed to principals. Linn said it was unclear how much of the money was allegedly pocketed.

"It took a long time for me to become fully aware of what the funds were, much less how they get distributed," he said. "We're asking that the assets be returned to the company for the benefits of operations of the hospital."

Allegations

Now, Corn, Linn and Dhawan have filed separate lawsuits against Avanti in Los Angeles Superior Court. Linn and Dhawan allege the company's principals engineered a complex corporate restructuring in 2011 that, unknown to them, resulted in minority shareholders being shut out of certain profit-sharing.

Corn, who still owns 30 percent of the company according to court filings, alleges further wrongdoing. Though he did not comment, his lawsuit alleges that the company manipulated financial summaries when applying for short-term loans, and that the company has received notices of noncompliance with health care protocols from state and federal agencies.

More seriously, he alleges gross negligence in the chain's emergency room procedures, citing the death of a patient who was not transferred in time to another hospital equipped to provide needed medical services. He claims the company delayed in transferring the patient because it was not in its economic interest.

The hospital death accusation is notable because Bell and Edwards' Emergent Medical Associates is also facing lawsuits for delays in transferring emergency room patients for monetary reasons.

In an interview, Linn said the company has had an operating loss since last year.

Michael Amir, an attorney who reviewed Corn's and Linn's lawsuits for the Business Journal, said that the fact that some of the allegations were made by a former chief executive and current principal gave them more weight, but also more cause for doubt.

"You're talking about someone who's supposedly an insider," Amir said, "but you also wonder how much of that is sour grapes."

Brietta Clark, a professor of health law at Loyola Law School Los Angeles, said that shareholder anger over payouts and allegations of pocketing money reflect inherent tensions at for-profit hospitals.

"This is one of the real challenges of any sort of for-profit model in health care," she said. "That necessarily puts you at odds with many of the broader missions or goals that people would expect of a hospital."