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UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA - LOS ANGELES DIVISION

In re

VERITY HEALTH SYSTEM OF CALIFORNIA, INC., *et al.*,

Debtors and Debtors In Possession.

☒ Affects All Debtors

☐ Affects Verity Health System of California, Inc.
☐ Affects O'Connor Hospital
☐ Affects Saint Louise Regional Hospital
☐ Affects St. Francis Medical Center
☐ Affects St. Vincent Medical Center
☐ Affects Seton Medical Center
☐ Affects O'Connor Hospital Foundation
☐ Affects Saint Louise Regional Hospital Foundation
☐ Affects St. Francis Medical Center of Lynwood Foundation
☐ Affects St. Vincent Foundation
☐ Affects St. Vincent Dialysis Center, Inc.
☐ Affects Seton Medical Center Foundation
☐ Affects Verity Business Services
☐ Affects Verity Medical Foundation
☐ Affects Verity Holdings, LLC
☐ Affects De Paul Ventures, LLC
☐ Affects De Paul Ventures - San Jose Dialysis, LLC

Debtors and Debtors In Possession.

Lead Case No. 2:18-bk-20151-ER

Jointly Administered With:
CASE NO.: 2:18-bk-20162-ER
CASE NO.: 2:18-bk-20163-ER
CASE NO.: 2:18-bk-20164-ER
CASE NO.: 2:18-bk-20165-ER
CASE NO.: 2:18-bk-20167-ER
CASE NO.: 2:18-bk-20168-ER
CASE NO.: 2:18-bk-20169-ER
CASE NO.: 2:18-bk-20171-ER
CASE NO.: 2:18-bk-20172-ER
CASE NO.: 2:18-bk-20173-ER
CASE NO.: 2:18-bk-20175-ER
CASE NO.: 2:18-bk-20176-ER
CASE NO.: 2:18-bk-20178-ER
CASE NO.: 2:18-bk-20179-ER
CASE NO.: 2:18-bk-20180-ER
CASE NO.: 2:18-bk-20171-ER

Chapter 11 Cases

Hon. Ernest M. Robles

NOTICE OF SUBMISSION OF DEBTORS' RESPONSE TO THE HEALTH CARE IMPACT STATEMENTS AND CONDITIONS PROPOSED BY JD HEALTHCARE, INC. [RELATES TO DKT. NO. 2306]

1820151190823000000000011

PLEASE TAKE NOTICE that, the Health Care Impact Statements (the "Impact Statements"), prepared by the California Attorney General's (the "Attorney General") expert, JD Healthcare, Inc. ("JD Healthcare"), were posted on the Attorney General's website, http://oag.ca.gov/charities/nonprofithosp, as follows:

1. On August 16, 2019, the Attorney General posed the Impact Statements analyzing the proposed sale of St. Francis Medical Center and St. Vincent Medical Center to Strategic Global Management, Inc. and/or one of its affiliated entities, pursuant to the Asset Purchase Agreement [Docket No. 2305-1], entered into by and between the parties and approved by the Bankruptcy Court [Docket No. 2306] (the "SGM Sale").

2. On August 19, 2019, the Attorney General posted the Impact Statement analyzing the SGM Sale with respect to Seton Medical Center, including its Daly City and Coastside Campuses.

PLEASE TAKE FURTHER NOTICE that the Impact Statements contain conditions recommended by JD Healthcare to the Attorney General. The Deputy Attorney General requested that Verity Health System of California, Inc. and the above-referenced affiliated debtors (collectively, the "Debtors"), the debtors and debtors in possession in these chapter 11 cases, submit a response addressing whether any of the conditions proposed in the Impact Statements constitute "deal breakers" with respect to consummation of the SGM Sale.

PLEASE TAKE FURTHER NOTICE that, on August 23, 2019, the Debtors submitted to the Attorney General their response to the Impact Statements. A true and correct copy of the Debtors' response to the Impact Statements is attached hereto as **Exhibit A**.

Dated: August 23, 2019

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By /s/ *Tania M. Moyron*
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EXHIBIT A

Verity Health

2040 E. Mariposa Avenue
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August 23, 2019

VIA EMAIL AND FEDEX
Scott Chan, Deputy Attorney General
California State Department of Justice
Office of the Attorney General
455 Golden Gate Avenue, Suite 11000
San Francisco, CA 94102-7004

Re: Response to August 16 and August 19, 2019 Correspondence
Summary of "Deal Breakers"

Dear Mr. Chan,

Please consider this letter the response of Verity Health System of California, Inc. and its affiliates ("Verity" or "Debtors") to your letters regarding the conditions proposed (the "Recommended Conditions") by JD Healthcare, Inc. ("JD Healthcare" or "Expert") in its Health Care Impact Statements ("Impact Statements"), analyzing the proposed sale of St. Francis Medical Center ("St. Francis"), St. Vincent Medical Center (St. Vincent"), and Seton Medical Center, including its Daly City and Coastside Campuses ("Seton") (collectively, the "Hospitals") to Strategic Global Management, Inc. and/or one of its affiliated entities ("SGM" or "Buyer") (the "Transaction") pursuant to the Asset Purchase Agreement (the "APA"), entered into by and between the parties and approved by the Bankruptcy Court [Docket No. 2305]. We appreciate the opportunity to provide this response.

For the reasons outlined below, if the Attorney General ("AG") adopts the Recommended Conditions, SGM will not proceed with acquiring the Hospitals. SGM confirmed this in its letter to you dated August 21, 2019, when it stated that "the conditions recommended in the Impact Statements are materially inconsistent with the conditions . . . agreed to in Schedule 8.6." Importantly, any condition that the AG adopts that is not consistent with Schedule 8.6 is, in our view, a "deal breaker." Further, if the AG adopts the Proposed Conditions and if the Debtors are unsuccessful in their efforts to cut off the conditions under Section 363 of the Bankruptcy Code[1]

[1] Verity reserves the right to challenge the AG's ability to impose conditions such as the Recommended Conditions in the context of a sale in bankruptcy pursuant to section 363 of the Bankruptcy Code. In this case and *In re Gardens Regional Hospital and Medical Center, Inc.*, 567 B.R. 820 (Bankr. C.D. Cal. 2017), the Bankruptcy Court expressly held, for example, that conditions imposed on a buyer by the Attorney General, as part of the Attorney General's review of the sale of a non-for-profit hospital, is an "interest in property" that can be stripped off the assets through a sale under section 363 of the Bankruptcy Code. *See also In re Verity Health Sys. of Cal., Inc.*, 598 B.R. 283, 293 (Bankr. C.D. 2018) (holding that the "Conditions are an "interest in property" within the meaning of §363(f). These ruling are consistent with rulings by the Second, Third, Fourth and Seventh Circuits, and many lower courts, which have interpreted "any interest" expansively to include not only in rem interests in property, but also

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and the sale to SGM does not proceed, the likely outcome is the closure of St. Vincent, Seton, and perhaps St. Francis. This would be an unnecessary and avoidable tragedy and would have a dire impact on countless patients, employees, vendors, and stakeholders. This is especially true here when SGM has agreed to continue to operate the Hospitals and to abide by the vast majority of the conditions imposed by the AG in its approval of the BlueMountain Transaction (the "2015 Conditions")[2] for the remaining term that the conditions apply to Verity, as set forth in Schedule 8.6 to the APA.

Consequently, we strongly request that your office not accept the Expert's Recommended Conditions, which are essentially a roll-forward of the 2015 Conditions based on the historic operations and not current patient care needs or market conditions. Instead, we encourage the AG to tailor the conditions to match those outlined in Schedule 8.6 providing SGM with the flexibility necessary to turn the Hospitals around financially, so they can continue to provide critical healthcare access to the communities they serve and thousands of jobs for the foreseeable future.

We further urge the Attorney General to exercise his discretion in a manner that considers the economic impact of the Recommended Conditions on the Hospitals. While the Impact Statements provide a significant amount of information related to the Hospitals background and the Transaction, the reports lack (i) any analysis of the economic impact that the 2015 Conditions have had on the Hospitals, and (ii) any cost-benefit analysis of the Recommended Conditions. Alarmingly, without regard to the economic and community realities, certain Recommended Conditions, if adopted, would force the Hospitals to maintain programs that not only lose significant amounts of money on an annual basis, but are unnecessary since the same services (and in some instances, more comprehensive or robust services) are already being provided at other hospitals in the area. To aid the Attorney General, we have provided evidence that considers the economic impact of the Recommended Conditions on the Hospitals both in this letter and in the enclosed, supporting declarations. We are happy to provide additional evidence and to discuss this further.

The Attorney General's consideration of the economic impact of the prospective conditions is critical. We, as operators of the Hospitals, know the 2015 Conditions were overly burdensome and hampered the Hospitals' ability to break even, let alone prosper. Indeed, the

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other obligations that *are "connected to or arise from the property being sold" or that could "potentially travel with the property being sold." See, e.g., In re La Paloma Generating, Co.*, 2017 WL 5197116, *4 (Bankr. D. Del. Nov. 9, 2017); PBBPC, Inc. v. OPK Biotech, LLC (In re PBBPC, Inc.), 484 B.R. 860 (1st Cir. B.A.P. 2013); *In re Vista Marketing Group Ltd.*, 557 B.R. 630 (Bankr. N.D. Ill. 2016); *United Mine Workers of Am. Combined Benefit Fund v. Walter Energy, Inc.*, 551 B.R. 631, 641 (N.D. Ala. 2016); *In re Tougher Indus.*, 2013 WL 1276501 (Bankr. N.D.N.Y. Mar. 27, 2013).

[2] These 2015 Conditions are contained in the AG's "Conditions to Change in Control and Governance of St. Francis Medical Center and Approval of the System Restructuring and Support Agreement by and among Daughters of Charity Health System, Certain Funds Managed by BlueMountain Capital Management, L.L.C., and Integrity Health, L.L.C." dated December 3, 2015.

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Hospitals filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on August 31, 2018 to stop hemorrhaging precious cash resources. Verity, its employees, its 10,000 vendors, and other parties have made tireless efforts during the tenure of the Chapter 11 cases to ensure continued patient care and to take the necessary steps to allow the Hospitals to be sold to a new operator that could successfully operate the Hospitals.

The Bankruptcy Court has now approved the Transaction, which paves the way for a better chapter for these Hospitals and the communities they serve. The Attorney General should carefully consider the foregoing and not impose any conditions, based largely on historic operations, that would unravel operational improvements resulting from the heroic efforts of Verity's employees and management to save these Hospitals and inexorably lead to their closure.

We also request the opportunity to meet with you and other key decisions makers before any conditions are finalized in this Transaction, given their importance and the fact that the Recommended Conditions would destroy the Transaction and have a negative impact on tens of thousands of patients, employees, vendors, and stakeholders.

I. <u>The 2015 Conditions and the Chapter 11 Cases</u>

Before discussing the Recommended Conditions, I would like you to have the benefit of my experience overseeing the operations and financial performance of the Hospitals. *See* Enclosed Declaration of Richard G. Adcock, Verity Health System of California, Inc. Chief Executive Officer. Upon my appointment of CEO as the Hospitals, two competing issues were immediately apparent: the Hospitals are (i) critically important to the communities they serve, but (ii) are damaged financially as a result of cumulative decisions made in the last two decades.

While my extensive experience in healthcare has assisted me in understanding and navigating the complex problems threatening the Hospitals, one thing has crystalized for me: *the Hospitals require operational flexibility to adjust to market needs and demands and to effectuate a financial turn-around*. The 2015 Conditions do not allow for that type of flexibility and therefore hamper the Hospitals' ability to succeed. Thus, it is imperative that the Attorney General consider the pragmatic realities of the Hospitals' operations when imposing conditions on the Hospitals. We strongly request that the AG tailor the conditions imposed on this Transaction to align with the Purchaser Approved Conditions in Schedule 8.6, providing SGM with the flexibility to close on the Transaction and turn the Hospitals around so they can continue to provide meaningful health care services, community benefits, and jobs to the communities they serve.

II. <u>SGM Was the Only Qualified Bidder for St. Francis, St. Vincent, and Seton</u>.

Verity conducted a robust process to market and solicit potential buyers. In June 2018, it engaged Cain Brothers, a division of KeyBanc Capital Markets ("Cain"), to identify potential

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buyers of some or all of the Verity hospitals and related assets and commenced discussions with those potential buyers. Cain prepared a Confidential Investment Memorandum and organized an online data site to share information with potential buyers, contacting over 181 prospective strategic and financial buyers beginning in July 2018 to solicit their interest in exploring a transaction regarding the Verity hospitals. As a result of its far-reaching marketing process, Cain received sixteen indications of interest or other proposals and continued to develop potential sales.

Verity, in consultation with Cain and its other advisors, selected SGM's offer to serve as the stalking-horse bid to acquire the assets of St. Francis, St. Vincent, St. Vincent Dialysis Center, Seton, and related assets (the "Assets") through a sale under section 363 of chapter 11 of title 11 of the United State Code (the "Bankruptcy Code"). Following extensive negotiations, SGM and St. Francis, St. Vincent, St. Vincent Dialysis Center, and Seton entered into the APA, which provides for the purchase of the Assets for $610 million, plus payments of cure costs, as set forth therein.

Thereafter, in accordance with the bidding procedures, Cain continued to actively market the Assets. Cain notified 90 parties of the sale process, directly sent the parties the bidding procedures approved by the bankruptcy court, and represented Cain's availability to assist in the bidding process. Thereafter, sixteen of those parties signaled ongoing interest by their requests for continued access to the data room containing information about the Assets.

Notwithstanding the time, energy, and resources dedicated to this process, SGM submitted the only qualified bid for St. Francis, St. Vincent, and Seton. *Again, and importantly, SGM has agreed to accept, in full or in large part, the majority of the* 2015 *Conditions imposed by the AG in its approval of the BlueMountain Transaction for the remainder of the term applicable to Verity*. SGM has not agreed to accept those 2015 Conditions in their entirety due to its need for flexibility to turn the Hospitals around financially and to modify or eliminate services that are not financially feasible to retain and/or not necessary to serve the community. The Bankruptcy Court entered orders (i) approving the APA, schedules and exhibits thereto, and (ii) authorizing the sale to SGM under section 363 of the Bankruptcy Code.

III. **If the Attorney General's Office Adopts the Conditions Proposed by JD Healthcare, SGM Will Not Acquire the Hospitals.**

Verity and SGM engaged in extensive discussions and negotiations about the 2015 Conditions, with Schedule 8.6 developed as a result of compromises and concessions made by the parties regarding what conditions SGM committed to accept, while ensuring it had the flexibility and opportunity to turn the failing healthcare system around. Pursuant to Section 8.6 of the APA, SGM negotiated the requirement to close on the Transaction only if the conditions imposed by the AG are "substantially consistent" with the conditions set forth in Schedule 8.6. As outlined in greater detail below, the Recommended Conditions are not substantially

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consistent with the conditions enumerated in Schedule 8.6 in a number of significant ways and, if adopted by the AG, will result in this Transaction failing. For the avoidance of any doubt, if the AG adopts and imposes any condition on this Transaction that is not consistent with Schedule 8.6, any such condition should be considered by the AG's office as a "deal breaker."

We highlight below some of the material ways in which the conditions proposed by the Expert diverge from Schedule 8.6.

A. The "term" of the Condition

In Schedule 8.6, there are a number of conditions that SGM accepted "for a term which coincides with the remaining term applicable to [the] condition" for the specific Hospital, as set forth in the 2015 Conditions. While SGM agreed to essentially stand in Verity's shoes and to honor the remaining term of the Prior Conditions, it was unwilling to commit to these 2015Conditions for a more extended period, as these conditions were a key factor contributing to the financial demise of the Hospitals and any requirement to honor these commitments for longer would inhibit SGM's ability to make operational changes necessary to turn the Hospitals around. SGM makes its point in its letter to you when it stated "the conditions agreed to in Schedule 8.6 reflect the appropriate and needed approach in support of efforts to address the significant, long standing operational, economic and physical plant challenges facing these Hospitals, many of which were noted in the Impact Statements."

It is worth noting that in at least some cases (and specifically for Seton), JD Healthcare has recommended that certain conditions be applied to SGM "for the remainder of the term" or in some cases for a period of time that is even shorter than the term remaining on the 2015 Conditions. The AG should apply this same standard to all of the conditions required of SGM (*i.e.*, not longer than the remaining term).

As outlined in greater detail below, if the AG does not allow SGM to honor its conditions for a term that runs concurrent with the term that currently applies to Verity, there is a significant risk that the Hospitals will close. This will result in the loss of critical community-based health care services, jobs, recoveries for creditors, and the loss of over $9 million annually in charity care and over $3,300,000 annually in community benefits currently provided by these Hospitals.

The closure of the Hospitals would be a tremendous and completely avoidable loss. By imposing conditions for a period of time that runs concurrent with the 2015 Conditions, the AG would help to ensure that the Transaction closes and the Hospitals remain open, potentially for much longer, once under new ownership, shed from burdensome historic liabilities and challenges and on more solid financial grounds. This will give SGM the time it needs to further evaluate the opportunities and challenges for these Hospitals and to determine what changes are appropriate to ensure their long-term viability and the best and most productive services for the Hospitals going forward. SGM can, at its election, and if financially prudent, continue to honor

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the 2015 Conditions and maintain the beds, services, and offerings beyond this term, but requiring it to do so will terminate this Transaction and result in the loss of all services before the 2015 Conditions have even lapsed.

B. Cancer Care

In its Recommended Conditions, JD Healthcare suggests that the AG require SGM to maintain cancer care at the Hospitals, including radiation therapy at St. Francis and St. Vincent, and inpatient oncology, interventional radiology, radiation therapy, and infusion service at Seton. This condition is a clear deal breaker for SGM.

As a threshold matter, it is important to note that none of the Hospitals offer a comprehensive oncology service today. *See* Enclosed Declaration of Tirso del Junco, Jr. M.D., Verity Health System of California, Inc. Chief Medical Officer. St. Francis, St. Vincent and Seton do not currently provide surgical oncology services. While Seton historically had a more robust oncology service line, two of the medical oncologists previously practicing at the Hospital retired and have not been replaced, which has resulted in a further decline in oncology services, including a significant decline in infusion services.

Importantly, demand for oncology services has been steadily on the decline at each Hospital. The reasons for this decline are a function of changing market conditions and are not a mystery. By its own account, the Expert found that St. Francis' cancer care volume decreased from fiscal year 2017 through fiscal year 2019. There are at least three other community hospitals offering cancer care to the same community of patients served by St. Francis. There has also been a decrease in oncology volume at St. Vincent over the last three years, with at least four other community hospitals and/or academic medical centers providing cancer care services to the same community of patients served by St. Vincent. JD Healthcare notes that cancer is the leading cause of death in Los Angeles. While this is very unfortunate and may well be true, the Expert has not suggested that this is the result of a lack of sufficient providers of oncology services or that the provision of cancer care services at St. Vincent and St. Francis is important in fighting this epidemic.

We cannot look at the provision of oncology services in a vacuum. Oncology is a very expensive service line. *See* Enclosed Declaration of Anita Chou, Verity Health System of California, Inc. Chief Financial Officer In FY 2018, St. Vincent provided 9,435 cancer treatments for a loss of $995,000. We would anticipate SGM losing an additional $547,000 as a result of its inability to access drug pricing under the federal 340B Drug Discount Program ("340B pricing"),[3] which would result in a projected net loss of approximately $1.5 million annual in the oncology service line . In FY 2018, Seton provided 8,429 in oncology treatments

[3] The 340B Drug Discount Program is a US federal government program created in 1992 that requires drug manufacturers to provide outpatient drugs to non-profit health care organizations at significantly reduced prices. As a for-profit enterprise, SGM is not eligible for 340B pricing.

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for a net loss of $3.8 million. SGM would have lost an additional $3 million as a result of its inability to access 340B pricing, with approximately $2.6 million attributable to higher oncology drug costs. It is not financially feasible to expect Seton, once owned by SGM, to operate an oncology program with diminishing volume and need at a loss of nearly $7 million per year, especially when the Hospital is already operating at an annual loss of $60 million. In FY 2018, St. Francis provided 15,556 oncology treatments for a total operating cost of $11.6 million. This service line generated a net income of $1.8 million. St. Francis will incur a loss of $262,000 under SGM ownership in light of its inability to access 340B drugs. Some portion of this would translate into additional costs for the St. Francis oncology program.

St. Vincent and Seton already sustain overwhelming losses each year. While St. Francis is operating at a modest profit, it has significant cash flow challenges and may not be financially successful if it had to stand on its own without the support of the system. Given these challenges, every dollar committed and lost impacts the ongoing operations and viability of the Hospitals. SGM recognized from the inception that maintaining oncology services without access to 340B pricing would negatively impact its ability to operate the Hospitals. While access to cancer care is critical, the Expert found sufficient alternative providers. Despite there being available cancer care providers in each of the Hospitals' communities, the Expert recommended requiring the Hospitals' admittedly partial cancer programs continue. The AG should not adopt these Recommended Conditions, which would require SGM to maintain an expensive, diminishing service line when there are alternative service providers in the Hospital communities.

C. Charity Care

SGM has committed to provide annual charity care funds equal to or greater than $430,384 for patients at St. Vincent, $8,000,000 for patients at St. Francis, and $935,405 for patients at Seton, for a term that coincides with the remaining term of the 2015 Conditions. This translates to a commitment of approximately $9,400,000 annually to support necessary medical services for patients in need of care. Any additional charity care requirements above these amounts are a deal breaker for SGM, as it would hinder the long term sustainability of the Hospitals' services.

We appreciate JD Healthcare's recognition that health reform and the Affordable Care Act ("ACA") have changed the need for charity care. We agree with JD Healthcare's suggestion that the AG should adjust the required commitment to charity care based on available data from time periods after the implementation of the ACA. However, a three-year lookback period is too long in light of the significant year-over-year changes in the need for charity care. Instead, the AG should look at the actual charity care provided in the past year by St. Francis, St. Vincent and Seton as a more appropriate barometer for the level of charity care that should be offered by the Hospitals prospectively. SGM has committed to a significant minimum amount of charity care in Schedule 8.6 and the AG should accept this commitment.

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SGM has agreed to administer the charity care funds under its existing financial assistance policy applicable across SGM's hospital system. In order to operate an efficient system, SGM will need to have one set of policies, procedures, and patient financial assistance applications. The Expert has recommended that SGM be required to operate under Verity's policy. SGM should be permitted to organize its administration of the charity care funds, consistent with its other hospitals, and in compliance with applicable state and federal law, without being required to continue Verity's specific policy.

D. Community Benefit

SGM has committed to provide annual community benefit services equal to or greater than $1,076,459 for the communities served by St. Vincent, $1,439,854 for the communities served by St. Francis, and $848,434 for the communities served by Seton, for a term that coincides with the remaining term of the Prior Conditions. Any additional community benefit program requirements above these amounts are a deal breaker for SGM, as it would hinder the long-term sustainability of the Hospitals' services. Further, SGM must be afforded the flexibility to determine how best to serve the community and which programs to provide on behalf of each Hospital.[4]

E. Capital Commitment

As of June 30, 2019, Verity expended approximately $172 million of the $180 million in capital commitments required as part of the 2015 Conditions applicable to Verity's six hospitals, leaving approximately $8 million unexpended by Verity. SGM has agreed to pay the previously required, but unexpended Verity capital commitment applicable to the three Hospitals it is acquiring. In order to determine SGM's share of the unexpended $8 million, we considered the Santa Clara County and SGM asset purchase agreements to arrive at the proxy value of the Verity hospitals of $845,000,000, comprised of $235,000,000 for O'Connor Hospital and Saint Louise Regional Hospital, and $610,000,000 for St. Francis, St. Vincent, and Seton. Based on these figures, SGM is acquiring approximately 72% of the Verity hospital assets. As such, SGM's portion of the outstanding capital commitment as of June 30, 2019, is approximately $5.8 million.

Provided that Verity does not expend any additional capital expenditures through the closing of the pending APA, then SGM would honor and commit to expend $5.8 million in capital commitments among St. Francis, St. Vincent, and Seton. If the remaining amount of the original capital commitment pursuant to the 2015 Conditions left unexpended through the closing of the APA is less than the above number, SGM would honor and commit to spend seventy-two percent (72%) of such lesser amount in capital commitments. We understand SGM

[4] Please note that although St. Francis Career College was referenced in the Expert's recommendations, American Career College bought St. Francis Career College in 2013 and has since closed the Lynwood Campus in 2019.

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would want to maintain the flexibility to determine how best to apportion these required expenditures among the Hospitals based on their individual needs and their operational priorities and to have the opportunity to expend such amounts over five (5) years following the closing pursuant to the APA.

F. Economic Impact of the Expert Proposed Conditions Generally

While the Impact Statements provide a significant amount of information about the Transaction, the Hospital operations and challenges, and the communities they serve, it lacks (i) any of the economic impact the 2015 Conditions have had on the Hospitals or that the Recommended Conditions would have on SGM, and (ii) any cost-benefit analysis of the conditions recommended by the Expert. Verity and SGM agree that many of the services provided by the Hospitals are essential to the communities they serve and that is why SGM has agreed to adopt many of the 2015 Conditions. The Impact Statements fail to consider and discuss the extent to which the economic impact of the proposed conditions guarantees a failed SGM transaction. In its letter to you, SGM states: "the conditions recommended in the Impact Statements are materially inconsistent with the conditions […] set forth in Schedule 8.6 to the APA." It goes on to say that "SGM would not accept the conditions proposed in the Impact Statements."

If the AG adopts the Recommended Conditions, based on the historical conditions, operations and needs and not the present reality, this will result in requirements for the Hospitals to maintain programs that not only lose a significant amount of money on an annual basis but that are also unnecessarily duplicative of other services (sometimes more comprehensive) already offered at other hospitals in the area. This will also result in SGM walking away from this Transaction.

As further discussed below, a failed SGM Transaction would mean closure for all the Hospitals resulting in the loss of access to medical care for hundreds of thousands of community members and patients, put thousands of employees out of work, and deny any financial recovery for former employees with pension rights, as well as other stakeholders.

By way of example, the Recommended Conditions require that SGM maintain transplant services at St. Vincent, including its newly developed liver transplant program, for at least five years from the Closing Date. St. Vincent established its liver transplant program earlier in 2019, performing a total of 10 liver transplants to date. At present, this program is not receiving any reimbursement as it is still going through the initial certification process. The liver transplant program places a significant financial burden on the Hospital. A third-party liver program expert consulting company has produced feasibility and performance projections for the St. Vincent program and anticipates that it will lose $21 million over 5 years, or somewhere in excess of 15% of the total value of St. Vincent. Liver transplant services were not a required service under the 2015 Conditions and SGM should not be required to maintain liver transplant services at St. Vincent as part of this Transaction.

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Additionally, the Recommended Conditions require SGM to contract with LA Care for St. Francis, and St. Vincent. Verity is currently involved in litigation with LA Care to recover approximately $15.2 million in underpaid and/or unpaid claims.[5] *See* St. Vincent Medical Center v. Local Initiative Health Authority for Los Angeles County dba L.A. Care Health Plan, Case No. 19-01002 at kccllc.net/verity. Requiring SGM to contract with LA Care is unreasonable in light of LA Care's inability to adequately ensure timely and full payment at market rates for services. When both parties can freely negotiate a new contract with needed assurances of payment at market rates, the community benefits. This is not possible if SGM is mandated to contract with LA Care regardless of the contract terms offered by LA Care or LA Care's performance or non-performance under the contract.

These are just a few examples of how the Recommended Conditions fail to take in to account the economic consequences of the suggestions and the impact these would have on hospital viability and prudent operations.

IV. <u>If the AG Imposes the Conditions Recommended by its Expert, and the Debtors are Unsuccessful in their Efforts to Cut Off the Conditions under Section 363 of the Bankruptcy Code, the SGM Sale Will Terminate and St. Vincent and Seton Will Close</u>.

A. The Debtors and Their Stakeholders Will Suffer Immediate Irreparable Harm if the SGM Sale Does Not Close.

The aftermath of a failed SGM sale is the prompt closure of St. Vincent and Seton in light of their unsustainable operational losses, the absence of an interested viable purchaser that would continue operations as acute care hospitals, and the almost certain lack of financing to continue their operations. While St. Francis would attempt a private sale in the bankruptcy case, the Debtors foresee significant challenges notwithstanding the fact that its financial performance may be stronger during parts of the year than the other Hospitals. Indeed, excluding QAF, since it is often difficult to rely on from a working capital perspective due to its sporadic payment pattern, St. Francis would need to borrow greater than $35 million from the Verity Hospital System throughout the year to manage large working capital fluctuations. The administrative expenses and risks associated with continuing the bankruptcy cases to attempt to identify a new buyer other than SGM, further threaten the Debtors' ability to finance and sell the Hospitals as going concerns and related recoveries to constituents. These threats are borne directly by the communities served by the Hospitals, their patients, employees, and other critical stakeholders, and are material considerations with which to assess the proposed SGM sale.

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[5] To add specific examples, one large category of claims at issue involves services that were authorized by LA Care through delegated vendors but that LA Care denied payment because it had no way to track the delegated vendors' authorization numbers. As a result, LA Care required timely filed electronic claims to be resubmitted in paper. Another example is that LA Care has improperly administered payments under "stop loss" provisions – denying payment to St. Francis, in particular, for services to some of the most needy patients.

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1. St. Vincent and Seton Will Likely Close.

St. Vincent and Seton are likely to close promptly after the SGM transaction fails for two significant reasons tied to their ongoing financial underperformance: (i) the Debtors cannot sustain the operational losses incurred by St. Vincent and Seton without the prospect of a potential purchaser, and (ii) the Debtors must conserve resources to underwrite a sale of St. Francis. St. Vincent and Seton (including both the Daly City and Coastside campuses) have combined operating losses greater than $105 million in the 10 months since filing bankruptcy.

The Expert acknowledges that "no other offers were received by the Bankruptcy Court to purchase and operate" St. Vincent and Seton. *See* St. Vincent Report at 86; Seton Report at 87. This finding is consistent with the results of the Debtors' extensive marketing efforts. As outlined in greater detail above, beginning in July 2018, the Debtors engaged Cain to identify potential buyers of some or all of the Debtors' Hospitals. Cain contacted over 181 strategic and financial buyers and received 11 indications of interest. None of these indications proposed purchasing and operating St. Vincent or Seton individually. The Debtors cannot sustain incurring ongoing operational losses to maintain the going-concern value of St. Vincent and Seton without the realistic prospect of a purchaser.

These closures would begin almost immediately. Because the failure of the SGM sale puts the recovery of secured creditors at risk, it is almost certain that the secured creditors would object to continued use of their cash collateral to subsidize the losses at St. Vincent and Seton. While the Debtors may be able to obtain an order authorizing the use of cash collateral over their objection, that use would be limited to the amount necessary to avoid harm to patients. Based on the experience of Debtors' counsel, St. Vincent and Seton would first seek court approval to close their emergency departments and close the Hospitals to new patients. Given the average length of stay for hospital inpatients, we would expect all acute care patients to be discharged within a week. We would expect St. Vincent to be closed in less than one month.

Closure of Seton would be much slower than St. Vincent, given the more involved process of the skilled nursing and sub-acute resident populations at both the Daly City and Coastside campuses, and would cost tens of millions of dollars to effectuate. We would immediately seek the assistance of the California Department of Public Health, the Center for Medicare and Medicaid Services, the Department of Health Care Services, Santa Clara and San Mateo Counties and other key governmental and non-governmental stake holders to find appropriate placements for the approximately 180 long term and subacute residents at Seton. However, the post-acute care delivery system in Northern California does not have the excess capacity to accept these residents. *See* Enclosed Declaration of Maya Altman, CEO for the Health Plan of San Mateo. We would anticipate many of these residents being displaced across the state and outside of the state in order to find appropriate and available beds and resources. The transfer trauma risk attendant to the closure of Seton's nursing facility would be significant with patients needing to be transferred, in many cases, hundreds of miles away from their communities, families and support networks.

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Thereafter, the Debtors would most likely attempt a private sale of St. Vincent and Seton after they are closed. After their extensive but ultimately unsuccessful marketing efforts, the Debtors believe that the most likely outcome is a sale to a real estate or similar purchaser without an interest in continuing or reopening the facilities as acute care hospitals, and without the need for Attorney General review. *See In re Gardens Reg'l Hosp. & Med. Ctr., Inc.*, 567 B.R. 820, 826-829 (Bankr. C.D. Cal. 2017) (Robles, J.) (holding that sale of a closed not for profit hospital is not subject to Attorney General review).

2. <u>St. Francis Will Attempt a Private Sale at a Depressed Value with Significant Financial Obstacles and Creditor Scrutiny</u>.

In the event the SGM transaction fails due to the imposition of conditions making continued operations economically unfeasible, the Debtors will turn their efforts to fund a renewed sale process for St. Francis, their only potentially profitable going-concern asset. A St. Francis sale process would face stiff headwinds and present significant liquidity demands, which would be further exacerbated if the Debtors are continuing to incur operating losses associated with St. Vincent and Seton. The Expert cites interviewees who "expressed that if this [SGM] transaction was not finalized, the Hospital would likely be acquired by another organization due to its history of financial success." *See* St. Francis Report at 85. However, this supposition does not account for the expenses and uncertainties associated with a single-facility sale.

St. Francis realizes substantial economic benefits from its integration in the Verity Health System that would be stripped in a single-facility sale. First, St. Francis cannot sustain itself solely on cash flow from operations. The primary receivables attributable to St. Francis operations—reimbursements and related supplemental payments on account of the Hospital Quality Assurance Fee program—are paid periodically during the year and substantially after the service period to which they relate. As stated previously, excluding QAF, St. Francis must borrow greater than $35 million from the Verity Hospital System throughout the year in order to manage its large working capital fluctuations. Historically, St. Francis has leveraged financing arrangements entered into by the Verity Health System. The obligated parties under those financing arrangements historically included VHS, O'Connor Hospital, Saint Louise Regional Hospital, Seton, St. Vincent, and St. Francis. St. Francis cannot achieve stable financial operations without access to credit historically supplied on a joint and several basis to the Verity Health System.

St. Francis benefits from the consolidated administrative functions and unified technology of the Verity Health System, which St. Francis would need to arrange for and purchase individually in anticipation of a single-facility sale. The total burden of the cost of the underlying IT systems and licensing agreements for the system, at a cost of more than $40 million per year, would likely be the burden of St. Francis alone. In addition, St. Francis would bear a significant portion of the current annual overhead costs of over $100 million that no longer could be spread across the other Hospitals. These two factors will put significant strain

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on the cash flow of the remaining Debtors and would ultimately make completing an extremely quick private sale of St. Francis critical to maintaining any value for the estate.

A private sale is more expedient, but, in the absence of a renewed, robust sale process, the Debtors expect the sale would yield a purchase price hundreds of millions of dollars lower than the SGM Transaction and would receive objections from constituents who would request a new marketing process. Based on the Debtors' experience through the extensive pre-bankruptcy and post-filing marketing efforts, the Debtors are very aware of (i) the difficulty in identifying a purchaser that is both interested in, and capable of, closing on such a transaction, and (ii) the large amount of time and money it takes to sustain ongoing operating losses while working with a prospective buyer through the complex sale process. In these circumstances, the Expert's comment, without support, that there would be "other buyers" if the SGM Transaction failed is at best unsupported and a gross oversimplification of what would be an involved, complicated process. Even if a new deal process were successful and yielded a willing buyer capable of closing, it is highly uncertain whether the Debtors could fund the ongoing operating capital necessary to continue to operate St. Francis while the sale worked its way through the rigorous bankruptcy, AG, and regulatory approval process.

The Debtors' creditors are also likely to object to a fire sale of St. Francis given the already small recoveries available if the SGM sale is successful. A private sale is likely to leave only a partial recovery for secured creditors and, as discussed below, no recovery for other critical stakeholders. These secured creditors and stakeholders are likely to carefully scrutinize such a transaction and demand a longer auction process in lieu of a private sale. Each of these likely demands from secured creditors, other stakeholders, and the Attorney General would expose St. Francis to further financial deterioration arising from the increased administrative and professional costs associated with a lengthy sale process as well as further losses from operations.

It should be noted that even if there are good sales prospects, Verity will likely have no choice but to close St. Francis pending a sale, putting the hospital license in suspense and closing all beds and service lines. This would require a prompt shut-down of St. Francis, including the closure of its emergency room and trauma center as well as its psychiatric unit. While a buyer could apply to have the St. Francis hospital license resurrected and taken out of suspense, this is not without consequence. As a Hospital that relies heavily on government reimbursement and QAF to survive, in taking the license out of suspense, a St. Francis buyer would need to apply for new Medicare and Medi-Cal provider agreements, enduring a period during which the hospital is open but not yet certified. In addition, St. Francis would not be eligible for QAF during the period of time when it is closed, which would also impact its QAF fees and payments upon reopening. All of this would likely have a negative impact on the value of St. Francis as a freestanding hospital as well as its timeline for reopening its emergency department and certain non-essential services.

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B. A Renewed Sale Process Will Materially Delay the Bankruptcy Cases.

The Debtors have administered and financed their bankruptcy cases and plan of liquidation assuming that the cases would conclude shortly after the SGM sale. If SGM does not consummate the sale, then the Debtors will incur additional, unexpected administrative expenses associated with continued operations as they pursue new sales and closures. These expenses—unanticipated by the Debtors and their lenders—will increasingly burden the Debtors' ability to fund their operations.

While difficult to predict, the Debtors anticipate that a single-facility private sale of St. Francis will take approximately five to six months to close. The bankruptcy court process, assuming that (a) a buyer could be located, and (b) the Debtors would seek a private sale, would last approximately six to eight weeks and involve soliciting potential purchasers, drafting and negotiating an asset purchase agreement and sale motion, and holding a sale hearing on three weeks' notice to interested parties. The balance of time is allocated to the 90 to 135-day Attorney General review process. This assumes that the private sale of St. Francis would not require a more belabored auction process in bankruptcy court; however, as noted above, creditors disappointed with partial or no recovery on their claims may convince the court that an auction process will result in a higher sale price.

The Debtors anticipate that the private sales of St. Vincent and Seton would take substantially less time to close if the facilities are not operating as acute care hospitals. The Debtors estimate that sales of St. Vincent and Seton could close in no less than two months on the most favorable timeline and for substantially less consideration. This assumes an expedited disposition of the facilities' patient populations, which we anticipate will be especially challenging for Seton's long-term patient populations at both the Daly City and Coastside campuses.

There is significant risk in the Debtors ability to fund an additional six-month sale process. These alternative sale timelines, through abbreviated, nevertheless require the Debtors to incur significant administrative expenses. As discussed, the Debtors incur cash flow losses of $450,000 every day. The Debtors have obtained $185 million of debtor in possession financing to cover these operational and administrative expenses during their bankruptcy cases because their stakeholders were satisfied that there was a high likelihood of consummating significant asset sales; this matures September 7, 2019. In fact, the financing terms are subject to strict case milestones and short-term budgets based upon consummating sales of the Hospitals by specific dates. *See* Docket No. 309-2 (DIP Credit Agreement, § 7.1 at 63) (the Debtors financial covenants include limits on budget variances during the bankruptcy cases); *see id.* (DIP Credit Agreement, § 9.1(q) at 72-76) (providing for defaults if Debtors fail to meet case deadlines including sale deadlines). Without the prospect of an imminent asset sale that would, at a minimum, cover the costs of financing, the Debtors' ability to obtain financing is a significant risk. The Debtors' access to cash collateral and proceeds of the O'Connor Hospital and Saint Louise Regional Hospital sale are likewise subject to the liens and limitations of the Debtors'

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secured creditors. The Debtors' ability to fund their operations becomes increasingly dubious as the bankruptcy cases continue without resolution.

C. Patients, Employees, Vendors, Community Members, and Other Essential Stakeholders Bear Directly the Ramifications of a Failed SGM Transaction.

The Attorney General should not ignore the significant economic ramifications of a failed SGM sale because of the negative healthcare impacts on patients and community members. If the SGM sale does not close, patients and community members will lose access to healthcare facilities. Extending the timeline to a sale by six months will also jeopardize the ability to finance the remaining hospital. Furthermore, the degradation in value realized from the asset sales will directly affect key stakeholder recoveries.

1. The Impact on Community Members and Patients

Failure to consummate the SGM sale likely results in the closure of St. Vincent and Seton and risks closure of St. Francis. The Expert recognizes the unique role the Hospitals play in their communities. Although the Debtors challenge the specifics of the proposed conditions, it is indisputable that these facilities provide access to essential healthcare services in their communities. Faced with the possibility of losing these facilities in their entirety, rote application of historical conditions must yield to the pragmatics of economics and demonstrable community need.

St. Francis is a critical safety-net provider of health care services, serving a large number of uninsured and underinsured patients. It is located in a medically underserved area and operates the only trauma center in the service area. It also provides critical acute inpatient psychiatric services as well as a mobile crisis evaluation team.

St. Vincent is the oldest hospital in Los Angeles, providing critical emergency room and other specialized services to the community it serves. In addition to serving almost 180 skilled nursing and subacute residents, Seton also operates a geriatric-psych service line and the only emergency department on the Peninsula in the 55-mile stretch between Santa Cruz and Daly City.

In addition to the possibility of losing these Hospitals, the communities would also lose the charity care and community benefits they offer. This would be a tragic and unnecessary loss.

2. The Impact on Vendors

It is the vendors that have supported the Hospitals during the pendency of the bankruptcy cases, allowing the Hospitals to stay open and to continue providing services in the ordinary course. Under the SGM purchase agreement, these vendors will receive payment in full for their

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support of Verity during its bankruptcy and a failed sale to SGM could put those payments at risk.

In addition, there are thousands of vendors whose contracts will be assumed by SGM pursuant to the sale. As a consequence, these vendors will be paid for their pre-petition claims an estimated total recovery of more than $50 million. For those vendors whose contracts are not being assumed by SGM, the sale will still provide millions of dollars of recoveries. In total, the failed sale to SGM would cause these vendors to lose tens of millions of dollars in recoveries. Further, there would be a loss of future services by these vendors that would provide the go-forward services to the operating hospitals.

3. The Impact on Employees

St. Francis, St. Vincent, and Seton have approximately 4,950 employees. SGM has committed to retain "substantially all" employees of the Debtors, as set forth in the APA. *See* Docket No, 2305-1 (SGM APA, § 5.3(a) at 27). Similarly, SGM has committed to participate in good faith negotiations of new collective bargaining agreements with the unions. *See id.* (SGM APA, § 4.7 at 25). The SGM sale presents the Debtors' stakeholders with the best possible alternative, and the failure of the SGM transaction will likely result in losing healthcare access for vulnerable populations as well as the loss of employment for thousands of employees.

V. Conclusion.

For all of the reasons outlined above, the AG should not adopt the Recommended Conditions. This would result in the certain failure of the SGM Transaction and the likely closure of St. Vincent, Seton, and perhaps St. Francis. This would be a devastating loss to the communities the Hospitals serve, to their patients, employees, vendors, creditors, and more. This would entail the unnecessary loss of historic, meaningful, community hospitals with robust histories, dedicated to providing charity care and community benefits, especially when as here, there is a ready buyer in SGM who has agreed to continue to operate the Hospitals and to abide by the vast majority of the 2015 Conditions for the period of time they apply to Verity. We urge you to tailor the conditions imposed on this Transaction to align with the Purchaser Approved Conditions in Schedule 8.6, providing SGM with the flexibility to close on the Transaction and turn the Hospitals around so they can continue to provide meaningful health care services, community benefits, and jobs to the communities they serve.

Sincerely,

Richard G. Adcock, CEO

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DECLARATION OF RICHARD G. ADCOCK

I, Richard G. Adcock, declare that I have personal knowledge of the facts set forth in this declaration, and I would competently testify to them under oath if called as a witness.

1. I am, and have been since January 2018, the Chief Executive Officer of Verity Health System of California, Inc. ("VHS"). Prior thereto, I served as VHS's Chief Operating Officer since August 2017.

2. I have extensive senior-level experience in the nonprofit healthcare arena, especially in the areas of healthcare delivery, hospital acute care services, health plan management, product management, acquisitions, integrations, population health management, budgeting, disease management and medical devices. I have meaningful experience in both the technology and healthcare industries in the areas of product development, business development, mergers and acquisitions, marketing, financing, strategic and tactical planning, human resources, and engineering.

3. Prior to VHS, from 2014 until 2017, I served as Executive Vice President and Chief Innovation Officer of Sanford Health, a large integrated health system headquartered in the Dakotas dedicated to health and healing. In this role, I was responsible for leading Sanford Health's growth and innovation, in addition to direct operational oversight of the following related entities: Sanford Research, Sanford Health Plan; Sanford Foundation (a philanthropic fundraising foundation); Sanford Frontiers (a commercial and real estate company); Profile by Sanford (a scientific weight loss program); and Sanford World Clinic (which operates clinics in multiple countries).

4. From 2012 to 2017, I served as the President of Sanford Frontiers and had the responsibility of starting a new entity within Sanford Health focused on innovative ventures. From 2008 to 2012, I served as Executive Vice President of Sanford Clinic. I was responsible both for (i) working directly with the President of the Clinic to the lead team of Vice Presidents in all aspects of management, and (ii) Sanford World Clinics operations, including the design, opening and operation of several global clinics. From

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2006 to 2008, I served as the Vice President of Sanford Clinic and was responsible for leading strategic, operational and financial aspects within Sanford Clinic. From 2004 to 2006, I served as Director of Clinical Operations at Sanford Children's Specialty Clinic and led the Pediatric Subspecialty Physician program and the clinical practice through all facets of the operation.

5. Prior to Sanford Health, I served as the Director of Engineering and Six Sigma Master Black Belt at GE Medical Systems, and before that served as the Vice President of Research and Development and the Co-Owner/Founder of Micro Medical Systems. I have a bachelor of science in business administration and a masters of business administration in healthcare management.

6. I have reviewed the conditions proposed (the "Recommended Conditions") by JD Healthcare, Inc. ("JD Healthcare" or "Expert") to the California Attorney General (the "Attorney General") in the Health Care Impact Statements (the "Reports"), analyzing the proposed sale of St. Francis Medical Center ("St. Francis"), St. Vincent Medical Center (St. Vincent"), and Seton Medical Center, including its Daly City and Coastside Campuses ("Seton") (collectively, the "Hospitals"), to Strategic Global Management, Inc. and its affiliated entities ("SGM"), as reflected in that certain Asset Purchase Agreement (the "APA").

7. Upon review of the Recommended Conditions, I urge the Attorney General <u>not</u> to issue the Recommended Conditions, and, instead, to impose the conditions to which SGM has agreed to in Schedule 8.6 to the APA.

8. As explained below in detail, the Attorney General should not impose the Recommended Conditions because they do not take into consideration the negative economic impact of the Recommended Conditions nor the negative economic impact of the previously imposed conditions on the Hospitals (the "2015 Conditions").

9. The Attorney General should exercise his oversight responsibilities and discretion to impose conditions that consider the economic impact to the Hospitals.

10. My extensive experience in healthcare has helped me understand and

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navigate the complex problems threatening the Hospitals.

11. Two competing issues were immediately apparent upon my appointment as CEO: the Hospitals are (i) critically important to the communities they serve, but (ii) are damaged financially as a result of cumulative decisions made in the last two decades.

12. After overseeing the operations and financial performance of the Hospitals, I concluded that the only feasible path to maintain Hospital operations was to initiate a bankruptcy process that would allow the transfer of the Hospitals to more financially stable operators, reduce existing liabilities, and commence a process in cooperation with the Attorney General to ensure the continued viability of these important community assets.

13. While SGM has the ability to keep these Hospitals open and help them to prosper, the Attorney General's role in that process cannot be understated.

14. Specifically, to fix the problems that presently threaten the Hospitals continued viability, the Attorney General must consider the pragmatic realities of the Hospitals' operations.

15. The Hospitals require operational flexibility to address the fast-paced changes in the healthcare market. I will use a specific example to illustrate my point. One of the 2015 Conditions requires that St. Francis maintains a fixed number of beds for pediatric patients. However, and by way of example, children in the St. Francis service area often go to the nearby children's hospital for treatment (e.g., Miller Children's, Children's Hospital of Los Angeles, and Women's Hospital). Consequently, St. Francis does not utilize many of the beds it is required to maintain pursuant to the condition. This results in unnecessary operating costs without attendant increases in revenue and, more importantly, prevents St. Francis from instead applying its resources to address the demonstrated needs of the community. In addition, these pediatric beds are needed as general adult inpatient beds. Put simply, 2015 Conditions do not reflect the needs of the market place. This is one of many examples that is repeated across service lines affected by the 2015 Conditions.

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16. The payor contracts present another example of the negative impact of the 2015 conditions on the Hospitals. In my experience, I have never seen a set of conditions that obligate the Hospitals, as providers, to accept a particular payor's contact no matter how disadvantageous the terms and conditions. The Attorney General's mandated requirement to remain in an economically damaging relationship obliterates the Hospitals' ability to negotiate appropriate terms, including reimbursement consistent with market conditions. The Hospital payor contracts are below-market as a result of many years of poor payor contract negotiations coupled with the 2015 Conditions. Stated differently, through the imposition of the conditions, the Attorney General transfers negotiating leverage to the payors and leaves the Hospitals severally disadvantaged. While the Attorney General certainly may not have intended that result at the time the 2015 Conditions were imposed, the 2015 Conditions had that impact and accelerated and contributed to the threats facing the Hospitals today.

17. While the impact reports provide a significant amount of information related to the Hospital's background and the SGM transaction, the reports are lacking (i) any analysis of the economic impact the 2015 Conditions have had on the Hospitals, and (ii) any cost benefit analysis of the Recommended Conditions.

18. Without regard to the economic and community realities, certain Recommended Conditions force the Hospitals to maintain programs that not only suffer significant losses an annual basis, but are unnecessary because the same services (and in some instances, more comprehensive services) are already provided at other Hospitals in the area.

19. The Attorney General's consideration of the economic impact of the Recommended Conditions is critical. As a Hospital operator, I know the 2015 Conditions were too burdensome and hampered the Hospitals ability to prosper, as discussed above. Verity, its employees, tens of thousands of vendors and other parties have made tireless efforts during the sale process to ensure high quality continued patient care and to take the necessary steps that would allow the Hospitals to be sold to a new operator that could

successfully operate the Hospitals. The Bankruptcy Court has now approved the sale to SGM, which paves the way for these Hospitals and the communities they serve to continue the Hospitals' mission of quality patient care.

20. The alternative to an SGM sale is, most likely, the closure of SVMC and Seton in light of their unsustainable operating losses, the absence of an interested viable purchaser that would continue operations as acute care hospitals, and the almost certain lack of financing to sustain their operations.

21. While SFMC would most likely attempt a private sale in the bankruptcy cases, I foresee significant challenges. SFMC's financial performance may be stronger during parts of the year than the other Hospitals; however, SFMC relies significantly on the Verity Hospital System to borrow an excess of $35 million throughout the year to achieve its financial success and has not demonstrated an ability to independently manage large working capital fluctuations. The administrative expenses and risks associated with continuing the cases to attempt to identify a new buyer other than SGM, further threaten the Debtors' ability to finance and sell the Hospitals as going concerns and related recoveries to constituents. These threats are borne directly by the communities served by the Hospitals, their patients, employees, and other critical stakeholders, and are material considerations with which to assess the proposed SGM sale.

22. The Reports recognize the unique role the Hospitals play in their communities. Although I disagree with the specifics of the Recommended Conditions, I believe it is indisputable that the Hospitals provide access to essential healthcare services in their communities. Faced with the possibility of losing the Hospitals in their entirety, rote application of the 2015 Conditions should yield to the pragmatics of economics and demonstrable patient care and community need.

23. If the SGM transaction does not close, the Debtors, employees, pension holders, other stakeholders, and community members, would be exposed to significant and unrecoverable health care and economic loss.

24. Among the stakeholders which will be harmed by a failed SGM sale are the

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vendors that have supported the Hospitals by providing credit terms throughout these cases. Under the SGM sale, these creditors will receive payment for their support of the Hospitals during the sale process. A failed sale to SGM would put that at risk. In addition, there are thousands of vendors whose contracts will likely be assumed by SGM in the sale. Consequently, these vendors will be paid for their pre-petition claims, an estimated total recovery for these vendors of $50 million. Even those vendors whose contracts are not assumed by SGM are still expected to receive millions of dollars of recoveries. In total, the failed sale to SGM would cost these vendors tens of millions of dollars in recoveries. Further, there would be a loss of future income for services provided to the operating Hospitals on a go-forward basis.

25. The Hospitals have approximately 4,900 employees. SGM has committed to retain "substantially all" employees of the Debtors, as set forth in the APA.

26. The SGM sale presents the Debtors' stakeholders with the best possible alternative, and the failure of the SGM transaction will likely result in a loss of healthcare access for vulnerable populations, as well as jobs of thousands of employees.

27. Based on the foregoing, I request the Attorney General carefully consider the foregoing and not impose conditions that would threaten to close the Hospitals or otherwise unwind stakeholders' heroic efforts to save these Hospitals.

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

Executed this 23rd day of August, 2019, in Santa Monica, California.

Richard G. Adcock

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DECLARATION OF ANITA CHOU

I, Anita Chou, declare, that if called as a witness, I would and could testify as follows based on my own personal knowledge.

1. I am the Chief Financial Officer ("CFO") of Verity Health System of California, Inc. ("VHS"). I became the Debtors' acting CFO on August 20, 2018, and on August 29, 2018, the board of directors appointed me as the CFO. Prior to my appointment as acting CFO, I served as the VHS SVP Hospital Finance, with oversight responsibilities over all of Verity Health System hospitals' CFOs from February 1, 2018 until August 19, 2018, and as the St. Vincent Medical Center CFO from March 2016 to February 2018. Prior to VHS, I spent three years at Prospect Medical Holdings from March 2013 to March 2016 in various senior level corporate finance positions including Hospital System CFO, ten years as the controller for three different hospital and hospital systems (*e.g.*, Saint John's Health Center & Affiliates, Valley Presbyterian Hospital, and USC Kenneth Norris Jr. Cancer Hospital), and three years as a Financial Market Analyst for El Camino Hospital. I received my Masters in Health Administration from the University of Southern California in 2005, and my Bachelor of Science from University of California, San Diego in 1998.

2. Debtor VHS, a California non-profit public benefit corporation, is the sole corporate member of the five debtor California non-profit public benefit corporations that operated six acute care hospitals (the "Hospitals"), including St. Francis Medical Center ("SFMC"), St. Vincent Medical Center ("SVMC") and Seton Medical Center, which includes its Daly City and Coastside Campuses ("Seton"). Seton operates under one consolidated general acute care hospital license. VHS, the Hospitals and their affiliated entities operated as a non-profit healthcare system in the State of California.

3. The statements herein are based upon my personal knowledge of the facts and information gathered by me in my capacity as CFO for VHS.

4. I have reviewed the Health Care Impact Statements (the "Reports"), analyzing the proposed sale of SFMC, SVMC and Seton to Strategic Global Management, Inc., and its affiliated entities ("SGM"), as reflected in that certain Asset Purchase Agreement (the "APA").

5. The report on SFMC, at pages 92-96, the report on SVMC, at pages 87-90, and the report on Seton, at pages 88-92, set forth JD's recommended conditions (the "Recommended Conditions") for the transactions to the California Attorney General (the "Attorney General"). I urge the Attorney General not to issue the proposed conditions and, instead, to impose the conditions to which SGM has agreed in Schedule 8.6 to the APA.

6. The Recommended Conditions for SFMC, SVMC and Seton that deviate from Schedule 8.6 attached to the APA are "deal breakers" and should not be imposed by the Attorney General.

A. St. Francis

7. The Recommended Conditions for SFMC include a requirement that, for at least 10 years from the closing date, SFMC maintain cancer services. The current cost to maintain cancer treatment at SFMC exceeds $11 million annually, which includes the financial advantages that permit SFMC, as a non-profit hospital, to use the 340B program. The 340B Drug Discount Program is a U.S. federal government program that requires drug manufacturers to provide outpatient drugs to eligible health care organizations and covered entities at significantly reduced prices. SGM will operate SFMC as a for-profit enterprise, and, therefore, the 340B program will no longer be available, increasing the cost of pharmaceuticals, and, therefore, the cancer program, by $262,000 per year.

8. The Recommended Conditions include a requirement that, for at least 10 years from the closing date, SFMC maintain Wound Care Services. The Wound Care Clinic operated at a $385,000 net loss in 2018 and is expected to continue to operate at a loss.

9. The Recommended Conditions include a requirement that, for at least 10 years from the closing date, SFMC maintain its participation in the Medi-Cal Managed Care Program, continuing its contracts with LA Care Health Plan and Health Net Community Solutions. With Managed Medi-Cal rates that are significantly below market, such a restriction will continue to impose a financial burden upon SFMC as well as hinder its ability to negotiate appropriate payor rates. These contracts have not been renegotiated in the last 5 years in part due to the imposition of the conditions.

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B. St. Vincent

10. The Recommended Conditions for SVMC include a requirement that, for at least 5 years from the closing date, SVMC maintain cancer services. The cancer treatment program at SVMC operated at a net loss in 2018 of $995,000. And, because SGM will operate SVMC as a for profit enterprise, SGM cannot utilize the benefit of the 340B program which will impose additional cost for pharmaceuticals by $547,000 per year, exacerbating existing operating losses at the facility of over $65 million annually. With the loss of the 340B program, cancer care at SVMC will operate at a projected increased net loss of approximately $1.5 million per year.

11. The Recommended Conditions include a requirement that, for 5 years after the closing date, SVMC will continue to provide liver transplant service. The liver transplant program at SVMC started in calendar year 2019. In fact, performance projections prepared by a third-party expert consultant in transplant programs show a 5-year net loss of $21 million for SVMC. Worse, currently SVMC is not receiving reimbursement for liver transplants because SVMC is still in process of being certified to perform these transplants. Finally, SGM will have to negotiate reimbursement rates with third party payors going forward which may not cover the cost of the surgeries.

12. The Recommended Conditions include a requirement that for 5 years from the closing date, SVMC shall maintain its participation in the Medi-Cal Managed Care program, including continuing contracts with LA Care Health Plan and Health Net Community Solutions, Inc. Just as in the case with SFMC, with Managed Medi-Cal rates that are significantly below market, such a restriction will continue to impose a financial burden upon SVMC as well as hinder its ability to negotiate appropriate payor rates. These contracts have not been renegotiated in more than 5 years in part due to the imposition of the conditions.

C. Seton and Seton Coastside

13. The Recommended Conditions include a requirement that for 6 years Seton continue to offer cancer services at its Daly City Campus. The cancer services at Seton operated at a net loss of $3.8 million in 2018. The loss of the 340B program will increase costs by $3 million, of which $2.6 million is attributable to the loss of infusion therapy services. It is not financially

feasible to operate a cancer program at a continuing loss of nearly $7 million per year for a facility that is currently operating at a loss of $60 million annually.

I declare under penalty of perjury that, to the best of my knowledge and after reasonable inquiry, the foregoing is true and correct.

Executed this 23rd day of August, 2019, in El Segundo, California.

Anita Chou
Chief Financial Officer

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DECLARATION OF TIRSO DEL JUNCO, JR., M.D.

I, Tirso del Junco, Jr., M.D., declare that if called as a witness, I would and could competently testify thereto, of my own personal knowledge as follows.

1. I am currently the Chief Medical Officer for Verity Health System of California, Inc. ("VHS"). I am licensed and authorized to practice medicine in the State of California. I have been with VHS since its beginning in December 2015. I have also served as VHS's Associate Chief Medical Officer and as St. Vincent Medical Center's Chief Medical Officer. Prior to joining VHS, I held several positions at Mission Community Hospital in Panorama City, including associate chief medical officer.

2. Debtor VHS, a California non-profit public benefit corporation, is the sole corporate member of the five debtor California non-profit public benefit corporations that operated six acute care hospitals (the "Hospitals"), including St. Francis Medical Center ("SFMC"), St. Vincent Medical Center ("SVMC") and Seton Medical Center, which includes its Daly City and Coastside Campuses ("Seton"). Seton operates under one consolidated general acute care hospital license. VHS, the Hospitals and their affiliated entities operated as a non-profit health care system in the State of California.

3. The statements herein are based upon my personal knowledge of the facts and information gathered by me in my capacity the Chief Medical Officer for VHS.

4. I have read the Health Care Impact Statements (the "Reports") prepared by JD Healthcare ("JD") analyzing the proposed sale of SFMC, SVMC and Seton to Strategic Global Management, Inc., and its affiliated entities ("SGM").

5. The report on SFMC, at pages 92-96, the report on SVMC, at pages 87-90, and the report on Seton and Seton Coastside, at pages 88-92, set forth JD's recommended conditions (the "Recommended Conditions") for the transactions to the California Attorney General (the "Attorney General").

6. The Recommended Conditions for SFMC, SVMC and Seton that deviate from Schedule 8.6 attached to the certain Asset Purchase Agreement are "deal breakers" and should not be adopted by the Attorney General.

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A. St. Francis Medical Center

7. The Recommended Conditions for SFMC include a requirement that, for at least 10 years from the closing date, SFMC maintain cancer services, including radiation oncology. First, SFMC currently does not have a full complement of cancer services to offer its patients. In fact, SFMC offers *only* radiation oncology, and does not provide infusion chemotherapy and does not have a formal surgical oncology program; SFMC patients who need these services go to other hospitals. All three of those cancer services are currently being provided to patients within the area by Long Beach Memorial, Downy PIH, Torrance Memorial Medical Center and Lakewood Community Hospital. In other words, other hospitals within the area offer a full array of cancer services that SFMC does not offer, and those hospitals can thoroughly meet the needs for such services in the area. SFMC, as a non-profit hospital, receives the benefit of the 340B program. The 340B Drug Discount Program is a U.S. federal government program that requires drug manufacturers to provide outpatient drugs to eligible health care organizations and covered entities at significantly reduced prices. SGM will operate SFMC as a for-profit hospital, and, therefore, the 340B program will no longer be available, thereby increasing the cost of supplies.

8. The Recommended Conditions include a requirement that, for at least 10 years from the closing date, SFMC maintain wound care services. The report fails to note that the wound care clinic was re-licensed as a multi-specialty clinic in 2019 (for gastrointestinal services and general surgery, among other specialties); requiring SFMC to continue to provide wound care in the multi-specialty clinic would prevent SFMC from providing in the same clinic at the same time—multi-specialty services to meet community needs. In addition, the report fails to note that the hyperbaric chamber that was utilized in connection with such wound care services was removed by the vendor in 2018. Other hospitals in the area provide wound care services for patients, including Long Beach Memorial, Torrance Memorial and Downey PIH.

B. St. Vincent Medical Center

9. The Recommended Conditions include a requirement that, for at least 5 years from the closing date, SVMC maintain cancer services, including radiation oncology. As is the case with SFMC, SVMC does *not* have a full complement of cancer services to offer its patients; SVMC does

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not provide infusion or infusion chemotherapy, and does not have a formal surgical oncology program. SVMC patients who require those services are required to go to other hospitals. All four of those services are currently being provided at California Hospital, Good Samaritan, White Memorial, Hollywood Presbyterian and the Norris Cancer Center at USC Keck. In other words, other hospitals within the area offer a full array of services that SVMC does not offer, thoroughly meeting the need for such services in the area. As is the case with SFMC, the 340B program, which permits SVMC as a non-profit hospital, to obtain cancer supplies, principally pharmaceuticals, from vendors at discounted pricing, cannot continue at SVMC because SGM will operate SVMC as a for-profit hospital. The inability to utilize the financial advantages of the 340B program will have a material impact, increasing costs to provide cancer care.

10. As to both SFMC and SVMC, there are three facilities designated as National Cancer Institutes within the Los Angeles area, including the Norris Cancer Center at Keck USC Medical Center, City of Hope and UCLA Medical Center. Those facilities provide superior cancer treatment to their patients. All three are within 25 miles of SFMC and SVMC.

11. The Recommended Conditions for SVMC include a requirement that, for 5 years after the closing date, SVMC continue to provide liver transplants. The liver transplant program at SVMC only started in 2019. The reality is that the community has 5 neighboring liver transplant centers, which provide the same transplant services as SVMC. The cost to maintain the services is high, best demonstrated by the fact that in regards to the 10 liver transplants surgeries performed so far in 2019, patients have stayed an average of 35 days, which is 15 days over the geometric mean length of stay ("GMLOS"), which is a benchmark to enable comparison of length of stay versus severity of illness, set forth by Medicare. Worse, at the present time, SVMC is not receiving reimbursements because it is awaiting Medicare review of the program for certification.

C. <u>Seton Medical Center and Seton Coastside</u>

12. The Recommended Conditions requiring Seton to provide cancer services at its Daly City Campus should not be required as a condition for approval of the sale by the Attorney General.

13. More specifically, the Recommended Conditions include a requirement that for 6 years from the closing date, Seton shall maintain cancer services at its Daly City Campus, including

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oncology services, radiation therapy and infusion services. Seton provides radiation oncology and infusion therapy, but does not have a formal surgical oncology program. Accordingly, just as is the case with SFMC and SVMC, Seton does not have the full complement of cancer services to offer its patients. Seton patients who need the full array of services, that includes surgical oncology, go to other hospitals. A full array of cancer services are currently being provided to patients within the area, at UCSF and Stanford, and at Mills Peninsula which is located within ten miles of Seton. Just as is the case with SFMC and SVMC, other hospitals within the area offer a full array of cancer services, thoroughly meeting the community's needs for such services. Finally, just as is the case with SFMC and SVMC, the 340B program cannot continue in a for-profit hospital as proposed by SGM for Seton. Accordingly, the cost for Seton to provide cancer care without the 340B program will dramatically increase.

I declare under penalty of perjury under the laws of the United State that the foregoing is true and correct. Executed this 23rd day of August, 2019, in Los Angeles, California.

Tirso del Junco, Jr., M.D.

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DECLARATION OF MAYA ALTMAN

I, Maya Altman, declare that I have personal knowledge of the facts set forth in this declaration and I would competently testify to them under oath if called as a witness.

1. I am the CEO for the Health Plan of San Mateo. My office is located at 801 Gateway Blvd., South San Francisco, California.

2. The Health Plan of San Mateo (HPSM) is a County Organized Health System (COHS) that contracts with the State of California to operate the Medi-Cal program in San Mateo County. HPSM is the single Medi-Cal plan in this county. HPSM contracts with providers in San Mateo County as well as nearby counties to provide health services, including long term care and skilled nursing care, for its members. Seton Medical Center and Seton Coastside both currently contract with HPSM. HPSM has approximately 140,000 members; nearly all of them are enrolled in Medi-Cal or dually eligible for both Medicare and Medi-Cal.

3. I have been the CEO of HPSM since 2005. Prior to this position, I was the Director of Finance and Administration for the San Mateo County Health Department. I started with San Mateo County Health in 1994 and worked in various capacities before assuming responsibility for finance and administration.

4. I received a Master's Degree in Public Policy from the University of California at Berkeley, and a Bachelor of Arts degree from Bryn Mawr College.

5. Seton Medical Center and Seton Coastside offer services to HPSM members that are unavailable or minimally available from other providers. For example, Seton Medical Center operates the only subacute unit in San Mateo County, a 44 bed unit fully occupied with nearly all Medi-Cal beneficiaries. Were Seton Medical Center to close, these ventilator dependent patients would have to be moved to facilities at a great distance from their families.

6. Seton Medical Center and Seton Coastside operate a combined total of 155 skilled nursing facility beds. HPSM is gravely concerned about the erosion of SNF resources in San Mateo County and the Bay Area for people who are publicly insured

through Medi-Cal and Medicare. This is a national trend but is especially problematic in San Mateo County where the population is aging faster than the rest of California. The county's population of residents over the age of 65 is projected to increase by 57% from 91,447 in 2015 to 160,366 in 2030. San Mateo County's In Home Support Services (IHSS) Medi-Cal population is already 26% over the age of 85 compared to 15% in the rest of California. San Mateo County has already lost 264 licensed SNF beds since 2009, making it extremely difficult to place Medi-Cal enrollees who need this level of care in nursing facilities.

7. Were Seton Medical Center and Seton Coastside to close, Medi-Cal beneficiaries needing skilled nursing facilities would have to be placed in facilities far away, most likely outside of the Bay Area and at a great distance from their families.

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I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

Executed this 21st day of August, 2019, in South San Francisco, CA, California.

Maya Altman