

**THIS EMERGENCY OMNIBUS MOTION SEEKS TO REJECT CERTAIN EXECUTORY CONTRACTS AS
OF THE CLOSING DATE OF THE SALE OF ST. FRANCIS MEDICAL CENTER**

**PARTIES RECEIVING THIS EMERGENCY MOTION SHOULD LOCATE THEIR NAMES AND CONTRACTS ON
THE EXHIBIT ATTACHED TO THIS MOTION. YOUR RIGHTS MAY BE AFFECTED BY
THIS EMERGENCY MOTION AND YOU SHOULD THEREFORE READ IT CAREFULLY.**

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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-20181-ER

Hon. Ernest M. Robles

Chapter 11 Cases

**DEBTORS' EMERGENCY MOTION AND SEVENTH
OMNIBUS MOTION TO REJECT, PURSUANT TO 11
U.S.C. § 365(A), CERTAIN PAYOR, ADMINISTRATIVE
AND RISK-SHARING AGREEMENTS;
MEMORANDUM OF POINTS AND AUTHORITIES
AND DECLARATION OF RICHARD G. ADCOCK**

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[Relates to Docket Nos. 4511, 4634, 4873, 4993, 5266]

Hearing:

Date: TBD

Time: TBD

Place: Courtroom 1568
225 E. Temple Street
Los Angeles, CA 90012

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EMERGENCY MOTION

Pursuant to Rule 9075-1 of the Local Bankruptcy Rules of the United States Bankruptcy Court for the Central District of California (the “LBR”), Verity Health System Of California, Inc. (“VHS”), and the above-referenced affiliated debtors, the debtors and debtors in possession (collectively, the “Debtors”), in the above-captioned chapter 11 bankruptcy cases (the “Cases”), hereby move, on an emergency basis (the “Motion”), for the entry of an order rejecting the agreements between St. Francis Medical Center (“SFMC” or “Hospital”) and the various health benefit plan payors and medical groups (collectively, the “Payors”) listed on **Exhibit A**¹ to the accompanying Memorandum of Points and Authorities (collectively, the “Agreements”) ² pursuant to § 365(a),³ effective as of the closing date (the “Closing Date”) of the sale (the “Sale”) of SFMC. The Debtors further request that the Court fix a deadline for the applicable contract counterparty to file a proof of claim arising from the rejection of the applicable Agreement under Rule 3002(c).

The Debtors have filed this emergency Motion to ensure they will not incur continued administrative expense liability under the Agreements following the Closing Date. The capitation and risk-sharing agreements to be rejected impose significant financial risk upon the Debtors, given that the cost of care associated with each capitated member is variable and the compensation provided to SFMC for each capitated member is fixed. *See Declaration of Richard G. Adcock* (the “Adcock Decl.”) attached hereto at ¶ 7. Each month, SFMC incurs approximately \$7.5 million of costs related to these agreements through out of network charges. *See id.* These costs are significant in magnitude and are variable; St. Francis could incur costs well in excess of \$7.5 million in a given month. *See id.* By rejecting the Agreements coincident with Closing, SFMC will end

¹ Pachulski Stang Ziehl & Jones LLP will address any objections or response to the relief sought in this Motion filed by clients of Dentons US LLP.

² Any counter-party to a contract listed on **Exhibit A** that is uncertain of the agreement being rejected by the Motion should contact counsel for the Debtors. The Debtors will attach a final exhibit to the order entered on the Motion with any updated or revised information.

³ Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and all “Rule” references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037. All “LBR” references are to the Local Bankruptcy Rules for the United States Bankruptcy Court for the Central District of California.

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1 its financial responsibility for the cost of care to capitated plan members and thereby avoid exposure
2 to future unknown expenses in excess of fixed revenue, which could be significant. *See id.*

3 The Court has already authorized by the Sale Order (as defined below) rejection as of the
4 Closing Date of those contracts and leases not assigned to the purchaser of SFMC. The Debtors
5 have further provided separate notice that the Agreements would otherwise be subject to rejection
6 without the need for a motion under the Plan (as defined below). Additionally, given that the
7 impending Sale has been public knowledge for many months, the counter-party Payors are
8 undoubtedly aware that this step was imminent. Indeed, pursuant to the assignment designation
9 process undertaken in connection with the Sale, each of the Payors has already been informed that
10 its applicable agreement with SFMC will **not** be assumed and assigned. In many cases, moreover,
11 the Debtors have been in direct communication with certain Payors to plan for the approaching
12 rejection of the Agreements.

13 Granting the relief requested in the Motion will also serve the collective interests of the
14 Payors and their enrolled patients by affording needed certainty concerning the treatment of the
15 Agreements and the effective date of rejection. By finalizing the rejection of the Agreements to
16 coincide with the Closing Date of the Sale, the Payors can immediately take steps to notify their
17 plan members, downstream vendors and primary care physicians of the associated change in status
18 of SFMC. Accordingly the Debtors request that the Court schedule the hearing on the Motion on
19 August 12, 2020, at 10:00 a.m. (Pacific Time)—the same date and time as hearings already
20 scheduled in these Cases.

21 By way of background, the Agreements relate to managed care, fee-for-service (“FFS”),
22 risk-sharing, capitation management and other agreements with health benefit plans, commercial
23 payors and independent physician associations (“IPAs”) for hospital facility services provided by
24 SFMC. Pursuant to the *Notice of Executory Contracts and Unexpired Leases Designated by Prime*
25 *Healthcare Services, Inc. for Assumption and Assignment, et seq.* [Docket No. 4873] (the
26 “Designation Notice”), Prime Healthcare Services, Inc. (the “Buyer”) has decided not to assume
27 the Agreements under the asset purchase agreement for its acquisition of SFMC [Docket No.
28

1 4471]. Following the Sale, the Debtors will no longer provide medical care for patients at SFMC
2 and, hence, the Agreements will provide no further benefit to the Debtors' estates.

3 Moreover, absent confirmation that rejection of the Agreements is coincident with the
4 closing of the Sale, the Debtors and their estates will suffer immediate and irreparable harm.
5 Presently, the Debtors anticipate that the Closing Date could be as soon as August 13, 2020, if the
6 motion [Docket No. 5199] authorizing the Sale free and clear of additional Attorney General
7 conditions is granted. *See* Adcock Decl at ¶ 6. Consequently, the Debtors seek entry of an order
8 on August 12, 2020, confirming that rejection of the Agreements shall be effective as of the Closing
9 Date so the Payors may appropriately notify their plan beneficiaries and other affected parties. As
10 the Court is aware, a prompt Closing Date generates substantial benefits to the Debtors' estates.⁴
11 However, the potential administrative exposure arising from post-closing continued performance
12 under the Agreements is substantial and would undermine the benefits of a prompt closing if the
13 Agreements are not definitively rejected as of the Closing Date. SFMC incurs approximately \$7.5
14 million of costs related to the Agreements through out of network charges, which can vary
15 significantly and could exceed \$7.5 million based on unforeseen conditions or events. *See* Adcock
16 Decl. at ¶ 7. Accordingly, the Debtors request that the Court set the Motion for hearing on August
17 12, 2020, to ensure that the Debtors' estates and stakeholders will realize the material economic
18 benefits of an early Sale close without the risk of ongoing administrative liability under the
19 Agreements.

20 Equally vital to this goal, an expedited hearing on the Motion will also provide certainty to
21 the Payors that they do not need to continue to pay for covered services provided after the Closing
22 Date. Moreover, an expedited hearing will permit the Payors to alert their enrolled members that
23 they should seek treatment at a medical facility approved by their applicable Payor or primary care
24 physician for treatment after the Closing Date. Upon the closing of the Sale, the Debtors will no
25 longer provide medical services at the Hospital to the patient members enrolled in the various health
26 care benefit plans offered or administered under the Agreements, nor will there be any future need

27 _____
28 ⁴ The Court recently remarked that the Debtors' Cases are "razor-thin." *See* Docket No. 5399 at 5
(citing *Declaration of Peter C. Chadwick* [Docket No. 5214] (the "Chadwick Decl.") ¶ 5 n.5).

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1 for the associated IPAs to continue to manage the facility services formerly offered by the Hospital
2 under the Agreements. However, given the numerous patient-members enrolled in the plans and
3 the presently inexact Closing Date, the Debtors anticipate that plans will be reluctant to inform their
4 members that the Hospital will no longer be covered until, either, the Sale actually closes or the
5 Debtors obtain a Court order definitively rejecting the Agreements. Given that rejection has been,
6 for over a month, a foregone conclusion under the Designation Notice (filed on June 16, 2020), the
7 plans and their patient-members are best served by a definitive rejection date on an expedited basis.

8 The contract counterparties will not be prejudiced if the Motion is set for hearing on an
9 emergency basis given that ample notice has already been provided concerning the rejection
10 process. **First**, on April 9, 2020, the Court entered the Sale Order which prospectively authorized
11 the rejection of any agreements not designated for assumption by the Buyer:

12 The Debtors intend, and ***are hereby authorized, to (A) reject,***
13 ***pursuant to § 365(a), all executory contracts to which SFMC is a***
14 ***party***, excluding (i) Assigned Contracts, and (ii) any prepetition
15 multiparty contract affecting more than one Debtor in addition to
16 SFMC, and, (B) reject and terminate, to the extent separately
17 authorized by this Court, pursuant to §§ 1113, 1114, and any other
applicable provision of the Bankruptcy Code, any CBA, pension plan
or health and welfare plan providing collectively bargained benefits
to which SFMC is a party or sponsor.

18 Sale Order ¶ 23. The Sale Order contemplates that the Debtors would file “an appropriate motion”
19 to reject such agreements, but, similar to the order [Docket No. 2068] approving the Santa Clara
20 County sale,⁵ the rejections would be deemed effective as of the Closing Date. *See id.* ¶ L (“The
21 Debtors shall file an appropriate motion to reject the contracts . . . prior to Closing and shall request
22 therein that the rejection be effective as of the Closing or as otherwise appropriate.”).

23 **Second**, the Second Amended and Restated Joint Plan of Liquidation [Docket No. 4993]
24 (the “Plan”) also provides notice of the expected rejection of the Agreements (among other
25 executory contracts and unexpired leases) without the need for further motion as follows:

26 ⁵ The order authorizing rejection under the Santa Clara County sale was entered post-closing, but
27 authorized rejection as of the closing “or as of the date of entry of this Order, as to be determined
28 by the Debtors.” *See* Docket No. 2068 at 2. There, the exigencies of rejection were less acute than
as presented by this Motion—the capitation and risk pool Agreements with SFMC are more
complicated than those with O’Connor Hospital and St. Louise Regional Hospital.

On the Effective Date, all Executory Agreements to which any Debtor is a party shall be deemed rejected as of the Effective Date, except for those Executory Agreements that (a) have been assumed or rejected pursuant to a Final Order of the Bankruptcy Court (including pursuant to any Sale Order), (b) are the subject of a separate motion to assume, assume and assign, or reject filed under § 365 on or before the Effective Date, or (c) are specifically designated as a contract or lease to be assumed on the Schedule of Assumed Contracts and no timely objection to the proposed assumption has been filed[.]

Plan § 11.1. Thus, parties already have notice that rejection will be effectuated without the need for a motion under the Plan.

Third, the Debtors have been communicating with various Payors concerning the forthcoming rejection of certain Agreements. *See* Adcock Decl. at ¶ 6. As a result of these ongoing communications, the Payors understand the Closing Date is imminent and have not expressed substantive opposition to rejection, except insofar as a mid-month rejection date might affect those Payors that pre-pay a monthly capitation payment to the Hospital. To address this concern the Debtors are willing to include the following, or similar, provision in the order granting the Motion:

Hospital agrees that, within ten (10) business days of the Closing Date, it shall refund to each capitated plan payor a pro rata amount of the monthly capitation payment paid by such payor to Hospital for that portion of the August remittance calculated from the Closing Date (inclusive of such date) to the end of the month.

Thus, granting relief on an emergency basis will not prejudice parties that received notice of the Agreements' eventual rejection under the Designation Notice and the contemplated procedures for rejection under the Sale Order and Plan, as well as through ongoing communications with the Debtors.

Based on the foregoing, the Debtors respectfully request that the Court grant the Motion for an emergency hearing because the proposed expedited hearing will not prejudice the counterparties to the Agreements and is in the best interests of the Debtors' estates, creditors, and the patient-members enrolled in the various health care benefit plans offered or administered under the Agreements.

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I.

SUMMARY OF REQUESTED RELIEF

Concurrently herewith, the Debtors have filed a motion seeking the entry of an order: (i) authorizing them to reject⁶ the Agreements effective as of the Closing Date of the Sale; (ii) fixing the last day for the applicable contract counterparty to file a proof of claim arising from the rejection of its Agreement under Rule 3002(c); and (iii) granting such other and further relief as is proper under the circumstances.

The Motion is based upon § 365, Rule 3002, LBRs 3007-1 and 9075-1(a), the attached Memorandum of Points and Authorities, the *Declaration of Richard Adcock in Support of Emergency First-Day Motions* [Docket No. 8], the Adcock Decl. and the Chadwick Decl., the arguments and statements of counsel to be made at the hearing on the Motion, and any other admissible evidence properly brought before the Court. The Debtors request that the Court take judicial notice of all documents filed with the Court in these Cases that relate to the Sale, the prior sale of the hospitals to Santa Clara County, and the Plan, as appropriate, in support of the Motion.

II.

RESPONSES

Any party opposing or responding to the Motion may present such response (the “Response”) at any time before or at the hearing on the Motion. *See* LBR 9075-1(a)(8). A Response must be a complete written or oral statement of all reasons in opposition to the Motion or in support, declarations and copies of all evidence on which the responding party intends to rely, and any responding memorandum of points and authorities. Pursuant to LBR 9013-1(h), the failure to file and serve a timely objection to the Motion may be deemed by the Court to be consent to the relief requested herein.

⁶ Nothing in this Motion precludes or otherwise affects one or more Debtors from asserting (a) any claim it may have against a party to an Agreement for the recovery of any outstanding unpaid or underpaid reimbursement or other compensation, or (b) that any Agreement is no longer executory.

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III.

SERVICE OF MOTION

Counsel to the Debtors will serve this Motion, the attached Memorandum of Points and Authorities, the Adcock Declaration, and any notice required by the Court on: (i) the counterparties to the Agreements; (ii) the Official Committee of Unsecured Creditors; (iii) the Debtors' prepetition secured creditors; (iv) Prime Healthcare Services, Inc.; (iv) the Office of the United States Trustee; and (v) any other parties on the Limited Service List set forth in the *Order Granting Emergency Motion of Debtors for Order Limiting Scope of Notice* [Docket No. 132]. To the extent necessary, the Debtors request that the Court waive compliance with LBR 9075-1(a)(6) and approve service (in addition to the means of services set forth in such LBR) by overnight delivery or via email.

IV.

RESERVATION OF RIGHTS

Nothing contained herein is intended or shall be construed as: (i) an admission as to the validity of any claim against the Debtors; (ii) a waiver of the Debtors' or any appropriate party in interest's rights to dispute the amount of, basis for, or validity of any claim against the Debtors; or (iii) a waiver of any claims or causes of action which may exist against any creditor or interest holder.

V.

CONCLUSION

WHEREFORE, for all the foregoing reasons and such additional reasons as may be advanced at or prior to the hearing regarding this Motion, the Debtors respectfully request that the Court hold a hearing on an emergency basis to consider the Debtors' request for an order (i) authorizing them to reject the Agreements effective as of the Closing Date of the Sale; (ii) fixing the last day for the applicable contract counterparty to file a proof of claim arising from the rejection of its Agreement under Rule 3002(c); and (iii) granting such other and further relief as is proper under the circumstances.

Dated: August 9, 2020

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By /s/ Tania M. Moyron
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MEMORANDUM OF POINTS AND AUTHORITIES

I.

INTRODUCTION

Verity Health System of California, Inc., a California nonprofit benefit corporation and the Debtor herein (“VHS”), and the above-referenced affiliated debtors (collectively, the “Debtors”), by and through their undersigned counsel, hereby file this Memorandum of Points and Authorities in support of their motion (the “Motion”) to reject pursuant to § 365(a)¹ the contracts listed on **Exhibit A** to the accompanying Memorandum of Points and Authorities, including all exhibits, schedules, attachments and amendments (collectively, the “Agreements”),² to which St. Francis Medical Center (“SFMC” or “Hospital”) is a party effective as of the closing date (the “Closing Date”) of the sale (the “Sale”) of SFMC. The Agreements relate to managed care, fee-for-service (“FFS”), risk-sharing, capitation management and administration, and other agreements with health benefit plans, commercial payors and independent physician associations (“IPAs”) for hospital services provided by SFMC.

The Debtors file this Motion ensure that they will not incur ongoing administrative liability under the Agreements following the Closing Date. The Court has already authorized rejection on the Closing Date pursuant to the SFMC sale order [Docket No. 4511] (the “Sale Order”). Additionally, given the Buyer’s prior Designation Notice [Docket No. 4873] to contract counterparties, the Payors are aware that rejection is imminent. Granting the relief requested in the Motion will also serve the collective interests of the Payors and their enrolled patients by affording needed certainty concerning the treatment of the Agreements and the effective date of rejection. By finalizing the rejection of the Agreements to coincide with the Closing Date of the Sale, the

¹ Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and all “Rule” references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037. All “LBR” references are to the Local Bankruptcy Rules for the United States Bankruptcy Court for the Central District of California.

² Any counter-party to a contract listed on **Exhibit A** hereto that is uncertain of the agreement being rejected by this Motion should contact counsel for the Debtors. The Debtors will attach a final exhibit to the order entered on this Motion with any updated or revised information.

1 Payors can immediately take steps to notify their plan members, downstream vendors and primary
2 care physicians of the associated change in status of SFMC.

3 The Buyer has declined an assignment of each of the Agreements and, thus, they will
4 provide no further benefit to the Debtors' bankruptcy estates (the "Estates") following the Sale.
5 Rejecting the Agreements and eliminating the Debtors' future obligations under them, if any, is
6 therefore in the best interest of the Estates. Consequently, the Debtors are permitted to reject the
7 Agreements as a legitimate exercise of their business judgment pursuant to § 365(a) and the Debtors
8 respectfully request that the Court grant the Motion.

9 **II.**

10 **JURISDICTION**

11 The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. This is
12 a core proceeding pursuant to 28 U.S.C. § 157(b)(2). The venue of the Cases is proper pursuant to
13 28 U.S.C. §§ 1408 and 1409. The statutory predicate for this Motion is § 365(a) and Rules 3002
14 and 6007.

15 **III.**

16 **STATEMENT OF FACTS**

17 **A. General Background**

18 1. On August 31, 2018 ("Petition Date"), each of the Debtors filed a voluntary petition
19 for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). The
20 Cases are currently being jointly administered before the Bankruptcy Court. [Docket No. 17].
21 Since the commencement of their Cases, the Debtors have been operating their businesses as
22 debtors in possession pursuant to §§ 1107 and 1108.

23 2. VHS is the sole corporate member of the following five Debtor California nonprofit
24 public benefit corporations that formerly operated or currently operate, as applicable, the following
25 acute care hospitals: O'Connor Hospital ("OCH"), St. Louise Regional Hospital ("SLRH"), Seton
26 Medical Center ("Seton"), SFMC and St. Vincent Medical Center ("SVMC").

27 3. On September 14, 2018, the Office of the United States Trustee appointed an
28 Official Committee of Unsecured Creditors in these Cases. [Docket No. 197.]

1 4. On December 27, 2019, the Court entered its *Order (A) Authorizing the Sale of*
2 *Certain of the Debtors' Assets to Santa Clara County Free and Clear of Liens, Claims and*
3 *Encumbrances, and Other Interests; (B) Approving the Assumption and Assignment of an*
4 *Unexpired Lease Related Thereto; and (C) Granting Related Relief* [Docket No. 1153] (the "SCC
5 Sale Order"). Pursuant to the SCC Sale Order, the Debtors sold OCH and SLRH and related assets
6 to the County of Santa Clara, a political subdivision of the State of California. The closing of that
7 sale occurred on February 28, 2019.

8 5. On January 3, 2020, the Debtors filed their *Notice re Termination of Asset Purchase*
9 *Agreement with Strategic Global Management, Inc.* [Docket No. 3899] ("Termination Notice").
10 As set forth in the Termination Notice, Strategic Global Management, Inc. ("SGM") failed to timely
11 close the APA (as defined in the Termination Notice) for the acquisition of SFMC, SVMC, Seton
12 and related assets. Consequently, the Debtors terminated the APA with SGM effective as of
13 December 27, 2019.

14 6. The Bankruptcy Court authorized SVMC to cease operations on an expedited basis
15 according to the closure plan approved by the *Order Granting Debtors' Emergency Motion for*
16 *Authorization to Close St. Vincent Medical Center* [Docket No. 3934]. As more fully described in
17 the *Debtors' Status Report re Closure of St. Vincent Medical Center dated January 23, 2020*
18 [Docket No. 3982] (the "Status Report"), the Debtors effectuated a smooth, safe and orderly
19 implementation of the SVMC closure plan. Emergency services were discontinued as of January
20 9, 2020, the dialysis center was closed on January 13, 2020, all SVMC inpatients were either
21 discharged or transferred by January 18, 2020, and all outpatient visits ceased as of January 22,
22 2020. Effective January 23, 2020, SVMC's transplant candidates were transferred to St. Joseph
23 Hospital (Orange). The Status Report also identified the government notifications delivered in
24 connection with the SVMC Closure.

25 7. Subsequently, on March 30, 2020, the Debtors' filed their *Emergency Motion for*
26 *the Entry of: (I) An Order (1) Approving Form of Asset Purchase Agreement, et seq.* (Docket No.
27 4365] ("SVMC Sale Motion"). The Court granted the SVMC Sale Motion on April 10, 2020. Upon
28

1 closing, SVMC transferred ownership of substantially all of its real and personal property assets to
2 the purchaser.

3 **B. SFMC Imminent Closing Date**

4 8. On April 9, 2020, the Bankruptcy Court entered the Sale Order, which prospectively
5 authorized rejection of agreements not designated for assumption by the Buyer:

6 The Debtors intend, and *are hereby authorized, to (A) reject,*
7 *pursuant to § 365(a), all executory contracts to which SFMC is a*
8 *party*, excluding (i) Assigned Contracts, and (ii) any prepetition
9 multiparty contract affecting more than one Debtor in addition to
10 SFMC, and, (B) reject and terminate, to the extent separately
11 authorized by this Court, pursuant to §§ 1113, 1114, and any other
applicable provision of the Bankruptcy Code, any CBA, pension plan
or health and welfare plan providing collectively bargained benefits
to which SFMC is a party or sponsor.

12 Sale Order ¶ 23. The Sale Order contemplates that the Debtors would file “an appropriate motion”
13 to reject such agreements, but, similar to the order [Docket No. 2068] approving the Santa Clara
14 County sale,³ the rejections would be deemed effective as of the Closing Date. *See id.* ¶ L (“The
15 Debtors shall file an appropriate motion to reject the contracts . . . prior to Closing and shall request
16 therein that the rejection be effective as of the Closing or as otherwise appropriate.”).

17 9. The California Attorney General has imposed certain conditions on its approval of
18 SFMC to Prime Healthcare Services, Inc., a for profit buyer. On July 27, 2020, the Debtors filed
19 their *Emergency Motion for the Entry of an Order: (I) Enforcing the Order Authorizing the Sale to*
20 *Prime Healthcare Services, Inc.; (II) Finding that the Sale is Free and Clear of Additional*
21 *Conditions; (III) Finding that the Attorney General Abused His Discretion in Imposing Additional*
22 *Conditions on the St. Francis Medical Center Sale, et seq.* [Docket No. 5199] (“SFMC Sale
23 Enforcement Motion”). The SFMC Sale Enforcement Motion has been scheduled for a hearing
24 before the Bankruptcy Court on August 12, 2020. Presently, the Debtors anticipate that the Closing

25 _____
26 ³ The order authorizing rejection under the Santa Clara County sale was entered post-closing, but
27 authorized rejection as of the closing “or as of the date of entry of this Order, as to be determined
28 by the Debtors.” *See* Docket No. 2068 at 2. There, the exigencies of rejection were less acute than
as presented by this Motion—the capitation and risk pool Agreements with SFMC are more
complicated than those with O’Connor Hospital and St. Louise Regional Hospital—and many
similar agreements were assigned to the purchaser in that transaction, unlike here.

1 Date could be as soon as August 13, 2020, if the SFMC Sale Enforcement Motion is granted. *See*
2 Adcock Decl. ¶ 6.

3 **C. The Agreements**

4 10. Like many health care providers, SFMC is reimbursed by health plans for hospital
5 facility services under both FFS and capitation models. Under the former, the health plan retains
6 the risk for the cost of health care provided to its members and retrospectively reimburses the
7 hospital provider for the (negotiated) cost of services rendered to such patients from time to time.
8 Under the latter, the hospital facility assumes the risk for the cost of health care (under a negotiated
9 division of financial responsibility). The plan prospectively pays the hospital a fixed, monthly “per
10 member, per month” payment (“PMPM”).⁴

11 11. As a result of the financial responsibility assumed by SFMC under the capitation
12 agreements, both on account of treatment provided at SFMC and on account of medical care
13 provided by other, downstream providers, SFMC is acutely concerned that, absent rejection, it
14 would remain obligated for such costs of care incurred by patients even after the Sale is closed.
15 The capitation and risk-sharing agreements to be rejected impose significant financial risk upon the
16 Debtors, given that the cost of care associated with each capitated member is variable and the
17 compensation provided to SFMC for each capitated member is fixed. *See* Adcock at ¶ 7. Each
18 month, St. Francis incurs approximately \$7.5 million of costs related to these agreements through
19 out of network charges. *See id.* These costs are significant in magnitude and are variable; St.
20 Francis could incur costs well in excess of \$7.5 million in a given month based on unforeseen
21 conditions or events. *See id.* By rejecting the Agreements coincident with Closing, SFMC will
22 end its financial responsibility for the cost of care to capitated plan members and thereby avoid
23 exposure to future unknown expenses in excess of fixed revenue, which could be significant. *See*
24 *id.*

25 12. In addition, in order to efficiently manage the care delivered to capitated plan
26 members (and minimize the potential for incurring costs, both internal and external, i.e., to third-

27 ⁴ As noted in the Debtors’ request for emergency relief, the Debtors will include the following, or
28 similar, provision in any order granting this Motion:

party, downstream providers, that exceed the PMPM revenue), the facility provider (here, SFMC) often agrees to a risk-sharing agreement with an IPA that has assumed the corresponding professional risk for the same members. Under these agreements, the IPA receives compensation for its efforts to optimize the nature and source of patient care needed by plan members. The amount of that compensation is determined by reference to a “risk pool” for each calendar “risk year.” A third party medical service organization (“MSO”), tracks the revenues and expenses assigned to the risk pools and performs the annual risk pool settlement reconciliation.

13. The Agreements that are the subject of the Motion include the foregoing FFS and capitation arrangements (between SFMC and the various health plans and payors), risk-sharing agreements (between SFMC and the various Groups) and administrative service agreements (between SFMC and the various MSOs). The Buyer has elected to decline an assignment of the Agreements under the Sale. Therefore, the Debtors seek to reject the Agreements as of the Closing Date in order to avoid further administrative expense to the Debtors (without waiver of any defenses or objections by the Debtors to the assertion or allowance of any such costs).

IV.

DISCUSSION

A. The Debtors Have the Right to Reject the Agreements Pursuant to § 365(a).

Section 365(a) authorizes a debtor in possession, “subject to the Court’s approval . . . [to] assume or reject any executory contract or unexpired lease of the debtor.” 11 U.S.C. § 365(a) (made applicable by § 1107(a)). A debtor in possession may assume or reject executory contracts for the benefit of its estate and its creditors. *Agarwal v. Pomona Valley Med. Grp., Inc. (In re Pomona Valley Med. Grp., Inc.)*, 476 F.3d 665, 671 (9th Cir. 2007); *In re Chi-Feng Huang*, 23 B.R. 798, 801 (B.A.P. 9th Cir. 1982) (“The primary issue is whether rejection would benefit the general

Hospital agrees that, within ten (10) business days of the Closing Date, it shall refund to each capitated plan payor a pro rata amount of the monthly capitation payment paid by such payor to Hospital for that portion of the August remittance calculated from the Closing Date (inclusive of such date) to the end of the month.

The Debtors submit that this language will resolve any dispute over pre-paid PMPMs.

unsecured creditors.”). “The purpose of the power to reject is to augment the estate of the debtor.” *Chi-Feng Huang*, 23 B.R. at 800 (quoting Krasnowiecki, *The Impact of the New Bankruptcy Reform Act on Real Estate Development and Financing*, 53 AM. BANKR. L.J. 363, 382 (1979)).

Section 365 does not provide a definition of what constitutes an executory contract. However, the Ninth Circuit has adopted the standard *Countryman* definition of an executory contract, which is a contract “under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.” *See, e.g., In re Robert L. Helms Constr. & Dev. Co., Inc.*, 139 F.3d 702, 705 (9th Cir. 1998).

Here, the parties to the Agreements have material unperformed obligations under the applicable contract.⁵ The Debtors, therefore, have filed the Motion to reject the Agreements effective as of the Closing Date pursuant to § 365(a).

B. Rejection of the Agreements Is Within the Debtors’ Sound Business Judgment.

In reviewing a debtor in possession’s decision to assume or reject an executory contract, a bankruptcy court should apply the “business judgment test” to determine whether to approve the assumption or rejection. *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 523, 104 S. Ct. 1188, 79 L. Ed. 2d 482 (1984) (recognizing that the business judgment rule is used in reviewing motions to reject executory contracts); *Pomona Valley Med. Grp.*, 476 F.3d at 670.

The business judgment standard requires that the bankruptcy court “presume that the debtor-in-possession acted prudently, on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the bankruptcy estate.” *Pomona Valley Med. Grp.*, 476 F.3d at 670. As a result, the bankruptcy court should approve rejection “unless it finds that the debtor-in-possession’s conclusion that rejection would be ‘advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice.’” *Id.* (quoting *Lubrizol Enters. v. Richmond Metal Finishers*, 756 F.2d 1043, 1047 (4th Cir. 1985)).

⁵ The Debtors reserve all rights to dispute that any of the Agreements is executory.

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1 The Motion should be granted because the Debtors' decision to reject the Agreements
2 indisputably falls within their sound business judgment. There is no further benefit to the Estates
3 to remain obligated on the Agreements following the Closing Date. The Buyer has decided not to
4 assume the Agreements under the APA, and, following the Sale, the Debtors will not provide
5 covered medical services to patients enrolled under the Agreements at SFMC. *See* Adcock
6 Declaration ¶¶ 4-5. Moreover, as discussed above, the capitation and risk-sharing agreements to
7 be rejected impose significant financial risk upon the Debtors, given that the cost of care associated
8 with each capitated member is variable and the compensation provided to SFMC for each capitated
9 member is fixed. *See id.* at ¶ 7. By rejecting the Agreements coincident with Closing, SFMC will
10 end its financial responsibility for the cost of care to capitated plan members and thereby avoid
11 exposure to future unknown expenses in excess of fixed revenue, which could be significant. *See*
12 *id.* Accordingly, rejection of the Agreements as of the Closing Date is in the best interest of the
13 Estates and falls squarely within the Debtors' sound business judgment. *Id.* at ¶ 8.

14 **V.**

15 **CONCLUSION**

16 **WHEREFORE**, for the foregoing reasons and such additional reasons as may be advanced
17 at or prior to the hearing on this Motion, the Debtors respectfully request that this Court enter an
18 order (i) authorizing them to reject⁶ the Agreements effective as of the Closing Date of the Sale,
19 (ii) fixing the last day for the applicable contract counterparty to file a proof of claim arising from
20 the rejection of its Agreement under Bankruptcy Rule 3002(c), and (iii) granting such other and
21 further relief as is proper under the circumstances.

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25
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27 ⁶ Nothing in this Motion precludes or otherwise affects one or more Debtors from asserting (a) any
28 claim it may have against a party to an Agreement for the recovery of any outstanding unpaid or
underpaid reimbursement or other compensation, or (b) that any Agreement is no longer executory.

Dated: August 9, 2020

DENTONS US LLP
SAMUEL R. MAIZEL
TANIA M. MOYRON
NICHOLAS A. KOFFROTH

By /s/ Tania M. Moyron
Tania M. Moyron

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DECLARATION OF RICHARD G. ADCOCK

I, Richard G. Adcock, declare, that if called as a witness, I would and could competently testify thereto, of my own personal knowledge, as follows:

1. I am the Chief Executive Officer of Verity Health System of California, Inc. (“VHS”). I became the Debtors’ Chief Executive Officer effective January 2018. Prior thereto, I served as VHS’s Chief Operating Officer since August 2017.

2. Except as otherwise indicated herein, this Declaration is based upon my personal knowledge, my review of relevant documents, information provided to me by employees of the Debtors or the Debtors’ legal and financial advisors, or my opinion based upon my experience, knowledge, and information concerning the Debtors’ operations and the healthcare industry. If called upon to testify, I would testify competently to the facts set forth in this Declaration.

3. This Declaration is in support of the *Debtors’ Emergency Motion and Seventh Omnibus Motion to Reject, Pursuant to 11 U.S.C. § 365(a), Certain Payor, Administrative and Risk-Sharing Agreements* (“Motion”)¹ and for all other purposes permitted by law.

4. St. Francis Medical Center (“SFMC”) is a party to various fee-for-service, managed care, risk-sharing, administrative and other related payor agreements (the “Agreements”) for the provision of hospital services to patients enrolled in the various health care benefit plans offered by the counterparties such agreements such parties. The Agreements that are the subject of the Motion are listed in **Exhibit A** to the Memorandum of Points and Authorities. There is no benefit to the Debtors’ Estates to remain obligated on the Agreements. After the Closing Date of the Sale of SFMC, the Debtors will no longer provide services to patients at SFMC.

5. I have concluded that there is no benefit to the Estates to remain obligated on the Agreements, if and to the extent any outstanding obligations remain to be performed by either party to an Agreement.

¹ Capitalized terms not otherwise defined herein have the meanings ascribed to them in the Motion.

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6. Having the Motion heard on an emergency basis will help provide certainty to the Debtors, the payors and numerous patients enrolled under the Agreements as set forth in the Motion. By finalizing the rejection of the Agreements to coincide with the Closing Date of the Sale, the Payors can immediately take steps to notify their plan members, downstream vendors and primary care physicians of the associated change in status of SFMC. The Debtors have been communicating with some of the Payors concerning the forthcoming rejection of the applicable Agreements. Further, having Motion heard on an emergency basis will serve the interests of the Sale, as the Debtors anticipate that the Closing Date could be as soon as August 13, 2020, if the motion [Docket No. 5199] authorizing the Sale free and clear of additional Attorney General conditions is granted.

7. Potential administrative expense claims arising from the Agreements can be substantial and threaten to undermine the benefit of a prompt closing if the Agreements are not clearly rejected as of the Closing Date. The capitation and risk-sharing agreements to be rejected impose significant financial risk upon the Debtors, given that the cost of care associated with each capitated member is variable and the compensation provided to SFMC for each capitated member is fixed. Each month, St. Francis incurs approximately \$7.5 million of costs related to these agreements through out of network charges. These costs are significant in magnitude and are variable; St. Francis could incur costs well in excess of \$7.5 million in a given month based on unforeseen conditions or events. By rejecting the Agreements coincident with Closing, SFMC will end its financial responsibility for the cost of care to capitated plan members and thereby avoid exposure to future unknown expenses in excess of fixed revenue, which could be significant.

8. Based on the foregoing, I have determined, in my business judgment, that rejection of the Agreements is in the best interest of the Estates.

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

Executed this 9th day of August, 2020, at Los Angeles, California.

/s/ Richard G. Adcock

Richard G. Adcock

Exhibit A

Verity Health System

St. Francis Medical Center - Fee for Service, Managed Care and Other Payor Agreements to be Rejected

| Ref # | Debtor | Contract Counterparty | Nature of Contact (1) |
|-------|--------|-----------------------|-----------------------|
|-------|--------|-----------------------|-----------------------|

Risk Agreements:

| | | | |
|---|------|---|--|
| 1 | SFMC | APPLECARE MEDICAL GROUP ST. FRANCIS, INC. ("AMGSF") | RISK SHARING AGREEMENT DATED AS OF JANUARY 1, 2004 |
| 2 | SFMC | APPLECARE MEDICAL GROUP, INC. ("AMGDO") | RISK SHARING AGREEMENT DATED AS OF JUNE 1, 2007 |
| 3 | SFMC | APPLECARE MEDICAL GROUP, INC. / APPLECARE MEDICAL GROUP ST. FRANCIS, INC. | ANCILLARY PROVIDER SERVICES AGREEMENT DATED AS OF FEBRUARY 1, 2000 |
| 4 | SFMC | APPLECARE MEDICAL MANAGEMENT, LLC | CAPITATION MANAGEMENT AGREEMENT DATED AS OF AUGUST 1, 2010 |

Capitation Agreements:

| | | | |
|----|------|-------------------------|--|
| 5 | SFMC | ALIGNMENT HEALTH SENIOR | MEDICARE ADVANTAGE HOSPITAL SERVICE AGREEMENT: AMGSF / AMGDO |
| 6 | SFMC | BLUE CROSS SENIOR | CAPITATION AGREEMENT: AMGSF / AMGDO |
| 7 | SFMC | BLUE SHIELD SENIOR | CAPITATION AGREEMENT: AMGSF / AMGDO |
| 8 | SFMC | EASY CHOICE SENIOR | CAPITATION AGREEMENT: AMGSF / AMGDO |
| 9 | SFMC | HEALTH NET | PROVIDER PARTICIPATION AGREEMENT EFFECTIVE MAY 1, 2008 |
| 10 | SFMC | HUMANA SENIOR | CAPITATION AGREEMENT: AMGSF / AMGDO |
| 11 | SFMC | L.A. CARE CMC | CAPITATION AGREEMENT: AMGSF / AMGDO |
| 12 | SFMC | SCAN SENIOR | CAPITATION AGREEMENT: AMGSF / AMGDO |
| 13 | SFMC | MOLINA MEDICAL | CAPITATION AGREEMENT: ANGELES |
| 14 | SFMC | CARE 1ST | CARE 1ST FULL RISK CONTRACT WITH ANGELES IPA MEDI-CAL EFFECTIVE 1-1-2017 |
| 15 | SFMC | CARE 1ST | CARE 1ST FULL RISK CONTRACT WITH APPLECARE MEDICAL GROUP DOWNEY-SELECT MEDICARE EFFECTIVE 7-1-2014 |
| 16 | SFMC | CARE 1ST | CARE 1ST FULL RISK CONTRACT WITH APPLECARE MEDICAL GROUP ST. FRANCIS MEDICARE EFFECTIVE 7-1-2014 |
| 17 | SFMC | CARE 1ST | CARE 1ST HOSPITAL SERVICES AGREEMENT EFFECTIVE 1-1-2013, INCLUDING MEDICARE FEE FOR SERVICE 1-1-2013 AMENDMENT (ADDING MEDICARE FULL RISK FOR APPLECARE MEDICAL GROUP DOWNEY 7-1-2013) |

Other Related Agreements: Hospital Services, Fee for Service, Facility Services, Ancillary Services, Provider Agreements, Managed Care Vendor

| | | | |
|----|------|--|---|
| 18 | SFMC | AETNA | CALIFORNIA NON-CAPITATED HOSPITAL SERVICES AGREEMENT / MEDICARE AMENDMENT EFFECTIVE 4/10/10 |
| 19 | SFMC | AHMC HEALTHCARE INC. | HOSPITAL SERVICES AGREEMENT |
| 20 | SFMC | AMERICA'S CHOICE PROVIDER NETWORK | HOSPITAL SERVICES AGREEMENT |
| 21 | SFMC | ANTHEM BLUE CROSS | FACILITY SERVICES AGREEMENT |
| 22 | SFMC | ANTHEM BLUE CROSS MEDICAL | HOSPITAL SERVICES AGREEMENT |
| 23 | SFMC | ALTAMED COMMERCIAL, SENIORCAP, MEDICAL | PARTICIPATING PROVIDER AGREEMENT |
| 24 | SFMC | ALTAMED SENIOR BUENA CARE | PARTICIPATING PROVIDER AGREEMENT |
| 25 | SFMC | BLUE SHIELD OF CALIFORNIA | HOSPITAL SERVICES AGREEMENT |
| 26 | SFMC | BRAND NEW DAY HMO - UNIVERSAL CARE | LETTER OF AGREEMENT |
| 27 | SFMC | CARE 1ST HEALTH PLAN HMO | HOSPITAL SERVICES AGREEMENT |
| 28 | SFMC | CENTRAL HEALTH PLAN | HOSPITAL SERVICES AGREEMENT |
| 29 | SFMC | DAVITA HEALTHCARE PARTNERS | HOSPITAL SERVICES AGREEMENT |
| 30 | SFMC | FIRST HEALTH GROUP CORP | FEE FOR SERVICE AGREEMENT |
| 31 | SFMC | HEALTH NET, INC. | PROVIDER PARTICIPATION AGREEMENT EFFECTIVE MAY 1, 2008 (FEE FOR SERVICE) |
| 32 | SFMC | CHOICE CARE - HUMANA HEALTH PLAN | FEE FOR SERVICE AGREEMENT |
| 33 | SFMC | HEALTH VALUE MANAGEMENT DBA CHOICE CARE NETWORK (HUMANA) | FEE FOR SERVICE AGREEMENT |
| 34 | SFMC | HERITAGE PROVIDER NETWORK INC | HOSPITAL SERVICES AGREEMENT |
| 35 | SFMC | HONORED CITIZENS CHOICE HEALTH PLAN MA (ALSO CITIZENS CHOICE HEALTHPLAN) | FEE FOR SERVICE AGREEMENT |
| 36 | SFMC | KAISER FOUNDATION HOSPITALS | HOSPITAL SERVICES AGREEMENT |
| 37 | SFMC | L.A. CARE HEALTH PLAN | HOSPITAL SERVICES AGREEMENT |
| 38 | SFMC | LATINO HEALTH CARE | FEE FOR SERVICE AGREEMENT |
| 39 | SFMC | LATINO HEALTH CARE | ANCILLARY SERVICES AGREEMENT |

Verity Health System

St. Francis Medical Center - Fee for Service, Managed Care and Other Payor Agreements to be Rejected

| Ref # | Debtor | Contract Counterparty | Nature of Contact (1) |
|-------|--------|---|----------------------------------|
| 40 | SFMC | MANAGED HEALTH NETWORK, INC. DBA MHN INC | FEE FOR SERVICE AGREEMENT |
| 41 | SFMC | MOLINA HEALTHCARE OF CALIFORNIA | HOSPITAL SERVICES AGREEMENT |
| 42 | SFMC | MULTIPLAN, INC. | FEE FOR SERVICE AGREEMENT |
| 43 | SFMC | SCAN HEALTH PLAN | FEE FOR SERVICE AGREEMENT |
| 44 | SFMC | IMPERIAL HEALTH PLAN VHS | FEE FOR SERVICE AGREEMENT |
| 45 | SFMC | NX HEALTH NETWORK | PARTICIPATING FACILITY AGREEMENT |
| 46 | SFMC | TRICARE HEALTH NET FEDERAL | FACILITY SERVICES AGREEMENT |
| 47 | SFMC | INTERPLAN | FEE FOR SERVICE AGREEMENT |
| 48 | SFMC | INTEGRATED HEALTH PLAN | FEE FOR SERVICE AGREEMENT |
| 49 | SFMC | COUNTY OF LOS ANGELES DEPARTMENT OF MENTAL HEALTH | PARTICIPATING PROVIDER AGREEMENT |
| 50 | SFMC | COUNTY OF LOS ANGELES DEPARTMENT OF PUBLIC HEALTH | PARTICIPATING PROVIDER AGREEMENT |
| 51 | SFMC | LONG BEACH MEMORIAL MEDICAL CENTER | PROVIDER SERVICES AGREEMENT |
| 52 | SFMC | UNIVERSITY OF SOUTHERN CALIFORNIA | PROVIDER SERVICES AGREEMENT |
| 53 | SFMC | CEDARS SINAI MEDICAL CENTER | PROVIDER SERVICES AGREEMENT |
| 54 | SFMC | SOUTHERN CALIFORNIA CROSSROADS | PARTICIPATING PROVIDER AGREEMENT |
| 55 | SFMC | BEVERLY HEALTHCARE COMMUNITY CARE CENTER DBA BEVERLY HEALTHCARE-CALIFORNIA, INC. | MANAGED CARE VENDOR AGREEMENT |
| 56 | SFMC | J&S HOME HEALTH SERVICES, INC. | MANAGED CARE VENDOR AGREEMENT |
| 57 | SFMC | M/S SURGERY CENTER, LLC | PARTICIPATING PROVIDER AGREEMENT |
| 58 | SFMC | BLOOMFIELD EAST | MANAGED CARE VENDOR AGREEMENT |

(1) Agreements may have been amended and supplemented from time to time