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Debtors and Debtors In Possession

**UNITED STATES DISTRICT COURT  
FOR THE CENTRAL DISTRICT OF CALIFORNIA  
WESTERN DIVISION - LOS ANGELES**

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

Case No. 2:20-cv-00613-DSF

Hon. Dale S. Fischer

VERITY HEALTH SYSTEM OF  
CALIFORNIA, INC., a California nonprofit  
public benefit corporation, ST. VINCENT  
MEDICAL CENTER, a California  
nonprofit public benefit corporation, ST.  
VINCENT DIALYSIS CENTER, INC., a  
California nonprofit public benefit  
corporation, and ST. FRANCIS MEDICAL  
CENTER, a California nonprofit public  
benefit corporation, SETON MEDICAL  
CENTER, a California nonprofit public  
benefit corporation, and VERITY  
HOLDINGS, LLC, a California limited  
liability company,

**PLAINTIFFS' ANSWER AND  
AFFIRMATIVE DEFENSES  
TO DEFENDANT  
STRATEGIC GLOBAL  
MANAGEMENT, INC.'S  
AMENDED  
COUNTERCLAIMS**

Plaintiffs,

v.

KALI P. CHAUDHURI, M.D., an  
individual, STRATEGIC GLOBAL  
MANAGEMENT, INC., a California  
corporation, KPC HEALTHCARE  
HOLDINGS, INC. a California Corporation  
KPC HEALTH PLAN HOLDINGS, INC. a  
California Corporation, KPC  
HEALTHCARE, INC. a Nevada  
Corporation, KPC GLOBAL  
MANAGEMENT, LLC, a California

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1 Limited Liability Company, and DOES 1  
through 500,

2 Defendants.

3 STRATEGIC GLOBAL MANAGEMENT,  
INC., a California corporation,

4 Counter-Plaintiff,

5 v.

6 VERITY HEALTH SYSTEM OF  
CALIFORNIA, INC., a California nonprofit  
7 public benefit corporation, ST. VINCENT  
MEDICAL CENTER, a California  
8 nonprofit public benefit corporation, ST.  
VINCENT DIALYSIS CENTER, INC., a  
9 California nonprofit public benefit  
corporation, and ST. FRANCIS MEDICAL  
10 CENTER, a California nonprofit public  
benefit corporation, SETON MEDICAL  
11 CENTER, a California nonprofit public  
benefit corporation, and VERITY  
12 HOLDINGS, LLC, a California limited  
liability company,

13 Counter-Defendants.  
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## ANSWER TO AMENDED COUNTERCLAIMS

Plaintiffs Verity Health System of California, Inc., Verity Holdings, LLC, St. Francis Medical Center, St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., and Seton Medical Center, by and through counsel, hereby answer Defendant Strategic Global Management Inc.'s ("SGM") Amended Counterclaims as follows. All allegations not expressly admitted are denied.<sup>1</sup>

### OVERVIEW

1. Before the instant litigation, VHS owned and operated four failing hospitals: St. Francis Hospital in Lynwood, CA; St. Vincent Medical Center, in Los Angeles, CA; Seton Hospital in Daly City, CA; and Seton Medical Center Coastsides in Moss Beach, CA. On August 31, 2018, VHS filed for Chapter 11 bankruptcy and sought to sell these hospitals' assets, along with other hospital assets that it owned at that time.

**Answer: Plaintiffs admit that they owned and operated St. Francis Hospital in Lynwood, CA; St. Vincent Medical Center, in Los Angeles, CA; Seton Hospital in Daly City, CA; and Seton Medical Center Coastsides in Moss Beach, CA. Plaintiffs further admit that, on August 31, 2018, Plaintiffs filed for Chapter 11 bankruptcy and sought to sell these hospitals' assets. All other allegations in this Paragraph are denied.**

2. In January 2019, SGM agreed to buy substantially all the assets of the four hospitals from VHS for a sale price of \$610 million, subject to certain adjustments (which could substantially reduce the purchase price), via a stalking

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<sup>1</sup> On September 30, 2020, the Court entered its Order (ECF 69) dismissing SGM's Count III, containing tortious breach of contract claims, in its entirety. SGM failed to amend any of its counterclaims by the Court's October 19, 2020 deadline, and so has "waive[d] its right to do so." ECF 69 at 3-4. Accordingly, Plaintiffs need not and do not specifically respond to SGM's Count III, which has been dismissed. ECF 58. Plaintiffs state out of an abundance of caution that all allegations in and/or supporting SGM's now-dismissed Count III are expressly denied.

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1 horse bid, in an effort to stem the losses, revitalize the hospitals, and allow them to  
2 continue to serve their communities. After applying its business strategies, SGM  
3 expected to obtain a substantial profit from the purchase. To that end, in or about  
4 January 2019, SGM and VHS entered into an Asset Purchase Agreement (“APA”)  
5 that set forth the parties’ rights and obligations in connection with the sale. SGM  
6 made a \$30 million good faith deposit upon entering the APA. VHS was obligated to  
7 return the deposit if it materially breached the APA.

8 **Answer: Plaintiffs admit that in January, 2019, SGM agreed to acquire the**  
9 **hospitals and their assets from Plaintiffs for a purchase price of \$610 million,**  
10 **plus assumption of certain liabilities, and payment of cure costs associated with**  
11 **any assumed leases, contracts and assumption of other obligations. Plaintiffs**  
12 **further admit that, on January 8, 2019, the SGM executed the APA and made a**  
13 **\$30 million deposit, pursuant to the terms of the APA. All other allegations in**  
14 **this Paragraph are denied.**

15 3. Unbeknownst to SGM, VHS’s operation of the hospitals in 2019 was  
16 nothing short of disastrous. Indeed, after wrongfully terminating the APA with SGM,  
17 VHS filed a motion to close St. Vincent. In that motion, VHS disclosed that its  
18 mismanagement of St. Vincent has caused the hospital to sustain financial losses of  
19 “more than \$65 million in fiscal year 2019 alone,” and that the hospital’s “operating  
20 losses are significant and unsustainable.”

21 **Answer: Plaintiffs admit that they filed a motion to close St. Vincent, which**  
22 **stated that St. Vincent sustained financial losses of “more than \$65 million in**  
23 **fiscal year 2019 alone,” and that the hospital’s “operating losses are significant**  
24 **and unsustainable.” The motion is a document that speaks for itself, and**  
25 **Plaintiffs deny any allegations that are inconsistent with the motion. All other**  
26 **allegations in this Paragraph are denied.**

27 4. But, VHS not only mismanaged its hospitals. After entering the APA,  
28 SGM also discovered that VHS had been illegally operating St. Vincent in violation

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of California law. When SGM confronted VHS with evidence of its violations, VHS did not even *attempt* to address the deficiencies. Rather, VHS denied the deficiencies existed and then falsely represented to SGM that it had satisfied all of its obligations under the APA and wrongfully demanded SGM close the sale immediately.

**Answer: Plaintiffs deny the allegations in Paragraph 4.**

5. Specifically, despite being well aware that it had not satisfied the APA's conditions precedent, including the conditions in sections 8.6 and 8.7 of the APA, VHS falsely represented that they had satisfied the conditions with the goal of: (1) forcing SGM to complete a sale without receiving the full consideration it was promised and/or (2) manufacturing a false claim that SGM breached an obligation to close as a pretext to terminate the APA and retain SGM's good faith \$30 million deposit, and (3) preventing SGM from exercising an option to terminate the APA if the sale did not close by December 31, 2019. Specifically, on November 20, 2019, VHS sent SGM a letter falsely representing that VHS had satisfied the conditions and demanding that SGM close on the sale on December 5, 2019. VHS did so, *despite* the fact that it had not complied with its contractual obligations and the conditions precedent to closing the sale, including, but not limited to: obtaining court authorization to transfer VHS's Medicare and Medi-Cal provider agreements pursuant to settlement agreements with the Centers for Medicare and Medicaid Services ("CMS" for Medicare) and the California Department of Health Care Services ("DHCS" for Medi-Cal), respectively; failing to respond to building and safety code violations and seismic compliance; and other contractual obligations discussed below. VHS's satisfaction of these obligations is not only contractually required, but also was essential to SGM's successful operation of the four hospitals and provision of healthcare services to the public.

**Answer: Plaintiffs deny the allegations in Paragraph 5.**

6. Although SGM repeatedly informed VHS that VHS had not satisfied its obligations, VHS nevertheless continued its illegitimate effort to unjustly enrich itself

on December 17, 2019 when it unilaterally announced that it was terminating the APA without returning SGM's \$30 million deposit.

**Answer: Plaintiffs deny the allegations in Paragraph 6.**

7. In sum, VHS: (1) failed and refused to honor its contractual obligations to SGM and repudiated the conditions in the APA; (2) nevertheless demanded that SGM immediately close the sale; (3) wrongfully terminated and repudiated its obligations under the APA; and (4) wrongfully retained SGM's \$30 million deposit and interest.

**Answer: Plaintiffs deny the allegations in Paragraph 7.**

### **JURISDICTION AND VENUE**

8. The United States District Court for the Central District of California has subject matter jurisdiction over SGM's Counter-Claim pursuant to 28 U.S.C. §1334 and pursuant to the District Court's Order Granting Motion to Withdraw Reference, entered on March 5, 2020.

**Answer: The allegations in Paragraph 8 contain legal conclusions or argument, to which no response is required. To the extent one is required, the allegations are denied.**

9. Venue for this adversary proceeding is proper pursuant to 28 U.S.C. § 1409.

**Answer: The allegations in Paragraph 9 contain legal conclusions or argument, to which no response is required. To the extent one is required, the allegations are denied.**

### **PARTIES**

10. Strategic Global Management, Inc. ("SGM") is a California corporation, with its principal place of business in Corona, California.

**Answer: Plaintiffs admit the allegations in Paragraph 10 on information and belief.**

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1 11. Verity Health Systems of California, Inc. is a California corporation with  
2 its principal place of business in Los Angeles, California.

3 **Answer: Plaintiffs admit the allegations in Paragraph 11.**

4 12. Verity Holdings, LLC is a California limited liability company with its  
5 principal place of business located at 1850 Sullivan Avenue in Daly City, California.

6 **Answer: Plaintiffs admit the allegations in Paragraph 12.**

7 13. St. Francis Medical Center is a California corporation with its principal  
8 place of business in Los Angeles, California. St. Francis engages in the business of  
9 the operation of the hospital known as St. Francis Medical Center, located at 3630 E.  
10 Imperial Highway, Lynwood, CA 90262, including the hospital pharmacy, laboratory  
11 and emergency department as well as through the medical office buildings and clinics  
12 owned or operated by St. Francis.

13 **Answer: Plaintiffs admit St. Francis Medical Center is a California**  
14 **corporation with its principal place of business in Los Angeles, California. St.**  
15 **Francis formerly engaged in the business of the operation of the hospital known**  
16 **as St. Francis Medical Center, located at 3630 E. Imperial Highway, Lynwood,**  
17 **CA 90262, including the hospital pharmacy, laboratory and emergency**  
18 **department as well as through the medical office buildings and clinics owned or**  
19 **operated by St. Francis.**

20 14. St. Vincent Medical Center and St. Vincent Dialysis Center, Inc. are  
21 California corporations with their principal place of business in Los Angeles,  
22 California. Before its closure, St. Vincent engaged in the business of the operation of  
23 the hospital known as St. Vincent Medical Center, located at 2131 W 3rd Street, Los  
24 Angeles, CA 90057, including the hospital pharmacy, laboratory and emergency  
25 department as well as through the medical office buildings and clinics owned or  
26 operated by St. Vincent.

27 **Answer: Plaintiffs admit the allegations in Paragraph 14.**

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15. Seton Medical Center is a California corporation. Seton engages in the business of the operation of two general acute care hospitals consisting of: (i) the hospital known as Seton Medical Center, located at 1900 Sullivan Avenue, Daly City, CA 94015, including the hospital pharmacy, laboratory and emergency department as well as through the medical office buildings and clinics owned or operated by Seton and (ii) the hospital known as Seton Medical Center Coastsides, located at 600 Marine Blvd, Moss Beach, CA 94038, including the hospital pharmacy, laboratory and emergency department as well as through the medical office buildings and clinics owned or operated by Seton.

**Answer: Plaintiffs admit Seton Medical Center is a California corporation. Seton engaged in the business of the operation of two general acute care hospitals consisting of: (i) the hospital known as Seton Medical Center, located at 1900 Sullivan Avenue, Daly City, CA 94015, including the hospital pharmacy, laboratory and emergency department as well as through the medical office buildings and clinics owned or operated by Seton and (ii) the hospital known as Seton Medical Center Coastsides, located at 600 Marine Blvd, Moss Beach, CA 94038, including the hospital pharmacy, laboratory and emergency department as well as through the medical office buildings and clinics owned or operated by Seton.**

### **GENERAL ALLEGATIONS**

16. On August 31, 2018, VHS filed voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code (the “Bankruptcy Code”) with the United States Bankruptcy Court for the Central District of California.

**Answer: Plaintiffs admit the allegations in Paragraph 16.**

17. In or about January 2019, SGM and VHS entered into an Asset Purchase Agreement.

**Answer: Plaintiffs admit that, on January 8, 2019, the SGM executed the APA. Plaintiffs further admit that, on May 2, 2019, the Bankruptcy Court**



entered an order [Bankr. Docket No. 2306] that, among other things, authorized the transaction, pursuant to the APA. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. All other allegations in this Paragraph are denied.

18. Pursuant to APA Section 1.2, SGM wired a \$30,000,000 deposit into VHS's bank account.

**Answer:** The allegations in Paragraph 18 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. Plaintiffs admit that SGM wired a \$30,000,000 deposit. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.

#### **I. THE APA'S KEY PROVISIONS.**

19. The APA contains several key provisions governing the parties' conduct with respect to the sale. Several of these provisions are set forth below.

**Answer:** The allegations in Paragraph 19 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.

#### **A. The APA Conditions Closing on VHS's Satisfaction of Its Contractual Obligations.**

##### **1. APA Section 1.3**

20. APA Section 1.3 conditions the closing of the transactions contemplated by the APA on the parties' satisfaction of their obligations under APA Articles 7 and 8. Specifically, Section 1.3 states as follows:

**1.3 Closing Date.** The consummation of the transactions contemplated by this Agreement (the "Closing") shall take

place at 10:00 a.m. local time at the offices of Dentons US LLP, 601 South Figueroa St., Suite 2500, Los Angeles, CA 90017-5704 (the day on which Closing actually occurs, the “Closing Date”) promptly but no later than ten (10) business days *following the satisfaction or waiver of the conditions set forth in ARTICLE 7 and ARTICLE 8*, other than those conditions that by their nature are to be satisfied at Closing but subject to fulfillment or waiver of those conditions. The Closing shall be deemed to occur and to be effective as of 11:59 p.m. Pacific time on the Closing Date (the “Effective Time”).

(APA, § 1.3, emphasis added.). Thus, the APA expressly required VHS to satisfy the conditions set forth in APA articles 7 and 8 as conditions precedent to demanding that SGM close the sale.

**Answer: The allegations in Paragraph 20 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.**

21. Article 8 of the APA also made clear that SGM had no obligation to close the sale unless VHS had met all of its obligations and conditions precedent to closing on or before the Closing Date.

**Answer: The allegations in Paragraph 21 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.**

## 2. APA Section 8.4 – Performance of Covenants

22. APA section 8.4 conditions the closing of the transaction upon VHS’s material performance and compliance with all of its other obligations, and covenants before SGM would have an obligation to close the transaction.

Specifically, Section 8.4 states:

8.4 Performance of Covenants. *Sellers shall have in all material respects performed or complied with each and all of the obligations, covenants, agreements and conditions required to be performed or complied with by Sellers on or prior to the Closing Date*; provided, however, this condition will be deemed to be satisfied unless (a) Sellers were given written notice of such failure to perform or comply and did not or could not cure such failure to perform or comply within fifteen (15) business days after receipt of such notice and (b) the respects in which such obligations, covenants, agreements and conditions have not been performed have had or would have a Material Adverse Effect.

(APA, § 8.4, emphasis added).

**Answer: The allegations in Paragraph 22 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.**

### 3. APA Section 4.6 – Conduct of the Business

23. APA section 4.6 required VHS to use commercially reasonable efforts to maintain the value of the hospitals and to comply with the law. Specifically, section 4.6 states:

4.6 Conduct of the Business. From the Signing Date until the Closing, or the earlier termination of this Agreement, without the prior written consent of Purchaser, Sellers shall, with respect to the ownership of the Assets and the operation of the Hospitals, use commercially reasonable efforts to, in each case except as would not have a Material Adverse Effect (except as otherwise noted):

(a) without regard to Material Adverse Effect, carry on Sellers' ownership of the Assets and the operation of the

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Hospitals consistent with past practice, but subject to the Bankruptcy Cases and Sellers' obligations and actions in connection therewith;

(b) maintain in effect the insurance and equipment replacement coverage with respect to the Assets;

(c) if and as permitted by the Bankruptcy Court, pay any bonuses payable under the Key Employee Retention Plan and Key Employee Incentive Plan of Sellers;

(d) maintain the Assets in materially the same condition as at present, ordinary wear and tear excepted;

(e) perform its obligations under all contracts with respect to the Assets in compliance with the Bankruptcy Code;

(f) following entry of the Sale Order, permit and allow reasonable access by Purchaser and its representatives (which shall include the right to send written materials, all of which shall be subject to Sellers' reasonable approval prior to delivery) to make offers of post-Closing employment to any of Sellers' personnel (including access by Purchasers and their representatives for the purpose of conducting open enrollment sessions for Purchasers' employee benefit plans and programs) and to establish relationships with physicians, medical staff and others having business relations with Sellers;

(g) with respect to material deficiencies, if any, cited by any governmental authority (other than the Attorney General of the State of California and other than with respect to Seismic requirements) or accreditation body in the most recent surveys conducted by each, cure or develop and timely implement a plan of correction that is acceptable to such governmental authority or such accreditation body;

(h) timely file or cause to be filed all material reports, notices and tax returns required to be filed and pay all required taxes as they come due;

(i) without regard to Material Adverse Effect, beginning on February 21, 2019 and in accordance with the Sellers' budget under their debtor in possession financing, timely pay any fees that are or become due and payable under QAF IV and QAF V;

(j) comply in all material respects with all Legal Requirements (including Environmental Laws) applicable to the conduct and operation of the Hospitals; and

(k) without regard to Material Adverse Effect, maintain all material approvals, permits and environmental permits relating to the Hospitals and the Assets.

(APA § 4.8). VHS breached this provision as set forth below.

**Answer: The allegations in Paragraph 23 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.**

4. APA Sections 2.8 & 2.10 Representations and Warranties with Respect to Compliance with Legal Requirements and Environmental Matters.

24. Under APA Article 2, Sections 2.8 and 2.10, VHS warranted and covenanted to SGM that the hospitals were in material compliance with all applicable laws and environmental regulations. Specifically sections 2.8 and 2.10 state:

#### Article 2: REPRESENTATIONS AND WARRANTIES OF SELLERS

"Each Seller hereby represents, warrants and covenants to Purchaser, severally (and not jointly) with respect to such Seller that the following matters are true and correct as of the Signing Date...

2.8 Compliance with Legal Requirements. Except as set forth in Schedule 2.8, to the knowledge of Sellers: each

Seller, with respect to the operation of the Hospitals, is in material compliance with all applicable laws, statutes, ordinances, orders, rules, regulation, policies, guidelines, licenses, certificates, judgments or decrees of all judicial or governmental authorities (federal, state, local, foreign or otherwise) (collectively, “**Legal Requirements**”)...

2.10 Environmental Matters... (b) Except as disclosed in Schedule 2.10(b), to the knowledge of Sellers, the operations of the Hospitals are not in material violation of any applicable limitations, restrictions, conditions, standards, prohibitions, requirements and obligations of Environmental Laws and related orders of any court or any other governmental authority.”

**Answer: The allegations in Paragraph 24 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.**

5. APA Section 8.6 – Attorney General Provisions

25. A critical component of the Sale negotiations between VHS and SGM was the need to anticipate and address, in the APA, the prospect that the California Attorney General (“AG”), in evaluating the proposed sale to SGM, might attach conditions that would impose costs on the purchaser that would effectively be “deal killers.” To address those concerns, the parties negotiated Section 8.6 of the APA (“Section 8.6”) to deal with what was termed “Additional Conditions.” The relevant portion of Section 8.6 is below.

8.6 Attorney General Provisions . . . . In the event the CA AG imposes conditions on the transactions contemplated by this Agreement, or on Purchaser in connection therewith, which are materially different than the Purchaser Approved Conditions set forth on Schedule 8.6 (the “Additional Conditions”), Sellers shall have the opportunity to file a motion with the Bankruptcy Court seeking the entry of an



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order (“Supplemental Sale Order”) finding that the Additional Conditions are an “interest in property” for purposes of 11 U.S.C. § 363(f), and that the Assets can be sold free and clear of the Additional Conditions without the imposition of any other conditions, which would adversely affect the Purchaser. . . . If Sellers determine not to seek such Supplemental Sale Order, or fail to obtain such Supplemental Sale Order within 60 days of the Attorney General’s imposition of Additional Conditions, Purchaser shall be entitled to terminate this Agreement and receive the return of its Good Faith Deposit. ***If Sellers timely obtain such Supplemental Sale Order from the Bankruptcy Court or another court, Purchaser shall have a period of 21 business days from the entry of such order (the “Evaluation Period”) to determine, in the exercise of the Purchaser’s reasonable business judgment and in consultation with Purchaser’s financing sources, whether to proceed to consummate the transactions contemplated by this Agreement . . . .*** For the avoidance of doubt, if the Debtors or any of the Consultation Parties dispute the reasonableness of the exercise of the Purchaser’s business judgment, such dispute shall be determined by the Bankruptcy Court only in the context of an adversary proceeding. If, at the conclusion of the Extended Evaluation Periods, such Supplemental Sale Order has not become a final, non-appealable order and Purchaser determines not to proceed, Purchaser shall have the right within ten (10) business days after the conclusion of the Extended Evaluation Periods to terminate this Agreement and receive the return of its Good Faith Deposit . . . . For purposes of this Section 8.6, “a final, non-appealable order” shall include a Supplemental Sale Order (i) which has been affirmed or the appeal of which has been dismissed by any appellate court and for which the relevant appeal period has expired (other than any right of appeal to the U.S. Supreme Court), or (ii) which has been withdrawn by the appellant. If the Supplemental Sale Order becomes a final, non-appealable order prior to the expiration of the Evaluation Period or, if applicable, the Extended Evaluation Periods, Purchaser shall consummate the Sale provided that all other conditions to closing have been satisfied . . . . For the

avoidance of doubt, neither this provision, nor any of the rights granted to the Purchaser herein, shall constitute a waiver of any party in interest's right to argue that any appeal from the Sale Order should be dismissed on statutory, Constitutional or equitable mootness grounds

(APA § 8.6, emphasis added).

**Answer: The allegations in Paragraph 25 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.**

26. Fundamental to SGM's agreement to the language of Section 8.6 was the creation of an "Evaluation Period" of 21 business days, which would start from the entry of the "Supplemental Sale Order." Because no one knew when they entered into the APA whether the bankruptcy court would enter a Supplemental Sale Order or what it would say, SGM required an "Evaluation Period" to ensure that it would not be obligated to close the transaction if, in the exercise of its reasonable business judgment, and after consultation with its funding sources, the Supplemental Sale Order was not satisfactory.

**Answer: The allegations in Paragraph 26 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.**

6. APA Section 8.7 – Medicare and Medi-Cal Provider Agreements

27. APA Section 8.7 conditions SGM's obligation to close on Verity's transferring of its Medicare and Medi-Cal provider agreements pursuant to settlements with the Centers for Medicare and Medicaid Services and the California Department of Health Care Services. Specifically, Section 8.7 states:

8.7 Medicare and Medi-Cal Provider Agreements. Sellers shall transfer their Medicare provider agreements *pursuant to a settlement agreement* with the Centers for Medicare and Medicaid Services (“CMS”) and shall transfer their Medi-Cal provider agreements *pursuant to a settlement agreement* with the California Department of Health Care Services (“DHCS”), which such settlement agreements shall result in: (i) *resolution of all outstanding financial defaults under any of Sellers’ Medicare and Medi-Cal provider agreements* and (ii) *full satisfaction, discharge, and release of any claims under the Medicare or Medi-Cal provider agreements, whether known or unknown, that CMS or DHCS, as applicable has against the Seller or Purchaser* for monetary liability arising under the Medicare or Medi-Cal provider agreements before the Effective Time;

...

(APA § 8.7, emphasis added).

**Answer: The allegations in Paragraph 27 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.**

#### 7. Section 11.2 – Damages for Sellers’ Breach

28. In entering into the APA, the parties contemplated the scenario where, as here, VHS materially breached the APA. In such an instance, the parties agreed that VHS must return SGM’s \$30 million deposit and that SGM may also sue for damage and/or specific performance to recover for the harm caused by VHS’s material breach. Specifically, under APA Section 11.2, if VHS commits any material default under the APA, SGM is entitled to the return of its \$30 million dollar deposit and may pursue its legal rights and remedies against VHS.

11.2 Seller Default. If Sellers commit any material default under this Agreement, Purchaser shall have the right to demand and receive a refund of the Deposit, and Purchaser may, in addition thereto, pursue any rights or remedies that

Purchaser may have under applicable law, including the right to sue for damages or specific performance.

(APA § 11.2). By including this provision in the APA, the parties intended and understood that SGM would have the right to demand and immediately receive the return of its \$30 million security deposit in the event that VHS materially breached the APA.

**Answer: The allegations in Paragraph 28 contain legal conclusions or argument, to which no response is required. The APA is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent a further response is deemed required, Plaintiffs deny any remaining allegations in this paragraph.**

29. In addition to a VHS breach (which it did for the numerous reasons stated herein), SGM would have also been entitled to a return of the deposit if the agreement did not close by December 31, 2019. Section 9.1(i) states:

9.1 Termination. This Agreement may be terminated at any time prior to Closing:

...

(i) by either Purchaser or Sellers if the Closing has not occurred (other than through the failure of any party seeking to terminate this Agreement to comply fully with its obligations under this Agreement) on or before December 31, 2019

(APA § 9.1(i)). In other words, under the APA, SGM would always be entitled to a return of its deposit if it did not breach an obligation to close. The parties certainly did not intend in the APA that VHS could ever wrongfully terminate the contract and somehow retain SGM's \$30 million deposit.

**Answer: Plaintiffs deny the allegations in Paragraph 29.**

1 **II. VHS DEPLOYS ITS SCHEME TO FORCE A SALE AND BREACHES**  
2 **THE APA.**

3 30. Between January and the fall of 2019, SGM and VHS worked  
4 constructively towards a closing of the Sale under the APA. These efforts included,  
5 among others, SGM's: negotiation and ultimate agreements with six (6) labor unions  
6 to modify their respective collective bargaining agreements; analysis of hundreds of  
7 executory contracts, including those with health plans, medical practice groups,  
8 independent physician associations (IPAs), vendors and suppliers, to be assumed and  
9 assigned to SGM upon closing; and the drafting of numerous separate agreements,  
10 such as an interim management agreement and sale-leaseback agreement, which  
11 would need to be completed and put in place at the time of closing. To that end, SGM  
12 devoted substantial financial resources to hire consultants, attorneys, and other expert  
13 and in-house personnel to address these and a myriad of other issues.

14 **Answer: Plaintiffs deny the allegations in Paragraph 30.**

15 31. In contrast, by the fall of 2019, VHS realized that it had not met its  
16 contractual obligations to SGM under at least Sections 8.6 and 8.7 of the APA. VHS  
17 also recognized that in light of the APA provision in section 9.1(i) allowing either  
18 party who was not in breach to terminate the APA without recourse if the sale had not  
19 closed as of December 31, 2019, VHS's failure to have satisfied all closing conditions  
20 would provide SGM, at a minimum, with an opportunity to terminate the APA on  
21 December 31 or renegotiate its terms. Thus, VHS developed a strategy to attempt to  
22 manufacture a breach (albeit artificial) by SGM which would give VHS a pretext to  
23 terminate the contract and keep SGM's \$30 million deposit and to allow VHS to  
24 attempt to pass the blame for its failure to close the sale to SGM.

25 **Answer: Plaintiffs deny the allegations in Paragraph 31.**

26  
27  
28

**A. VHS Fails to Satisfy The Conditions Precedent Condition Including Those Stated in Sections 8.6 and 8.7 of the APA.**

32. VHS did not satisfy all conditions to close as required by the APA. Notably, VHS did not satisfy the condition set forth in section 8.6 of the APA before it improperly sent notice of closing on November 20, 2019. Indeed, the condition in 8.6 was never satisfied by VHS nor was it excused by SGM.

**Answer:** Plaintiffs admit that they sent the notice of closing on November 20, 2019. The notice of closing is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the notice of closing. On November 14, 2019, the Bankruptcy Court entered the *Order Granting “Debtors Emergency Motion for the Entry of an Order: (I) Enforcing the Sale Order Authorizing the Sale to Strategic Global Management, Inc.; (II) Finding That the Sale Is Free and Clear of Conditions Materially Different Than Those Approved by the Court; (III) Finding That the Attorney General Abused His Discretion in Imposing Conditions on That Sale; and (IV) Granting Related Relief” [Doc. 3188]* [Bankr. Docket No. 3611], thereby satisfying Section 8.6 of the APA. The foregoing documents speak for themselves, and Plaintiffs deny any allegations that are inconsistent with the foregoing documents. Further, Plaintiffs deny the remaining allegations in Paragraph 32, including allegations that contain legal conclusions or argument to which no response is required. To the extent a further response is deemed required, the remaining allegations in this paragraph are denied.

33. VHS also did not satisfy the condition in section 8.7. As stated above, APA Section 8.7 obligated VHS to transfer its Medi-Care and Medi-Cal provider agreements to SGM pursuant to “settlement agreements” with the Centers for Medicare and Medicaid Services (“CMS”) and the California Department of Health Care Services (“DHCS”) which “shall result in: (i) resolution of all outstanding financial defaults under any of Sellers’ . . . Medi-Cal provider agreements and (ii)



1 full satisfaction, discharge and release of any claims under the . . . Medi-Cal provider  
2 agreements, whether known or unknown, that . . . DHCS . . . has against the Seller or  
3 Purchaser for monetary liability arising under the . . . Medi-Cal provider agreements  
4 before the Effective Time....” Despite this plain language, VHS did not comply with  
5 this obligation.

6 **Answer:** The APA is a document that speaks for itself, and Plaintiffs deny  
7 any allegations that are inconsistent with the APA. With respect to California  
8 Department of Health Care Services (“DHCS”), Plaintiffs secured the DHCS  
9 Order [Bankr. Docket No. 3372] from the Bankruptcy Court authorizing the  
10 transfer free and clear of any interests asserted by DHCS, in addition to the Sale  
11 Order which terminated any creditor’s recoupment rights [Docket No. 2306].  
12 Those Orders afforded equal or greater protection to SGM than any settlement  
13 could have, thereby satisfying Section 8.7 with respect to DHCS. SGM  
14 disagreed that the DHCS Order and the Sale Order satisfied Section 8.7.  
15 Consequently, although not necessary but given SGM’s position, on November  
16 22, 2019, Plaintiffs reached a settlement agreement with DHCS, which the  
17 Bankruptcy Court approved [Bankr. Docket Nos. 3786 & 3787]. On November  
18 19, 2019, Plaintiffs obtained a settlement with the Centers for Medicare and  
19 Medicaid Services, an agency of the United States Department of Health &  
20 Human Services, providing for the transfer of their Medicare Provider  
21 Agreements to SGM without successor liability, thereby satisfying their  
22 remaining obligations under Section 8.7 of the APA [Bankr. Docket No. 3680].  
23 The foregoing documents speak for themselves, and Plaintiffs deny any  
24 allegations that are inconsistent with the foregoing documents. Further,  
25 Plaintiffs deny the remaining allegations in Paragraph 33, including allegations  
26 that contain legal conclusions or argument to which no response is required. To  
27 the extent a further response is deemed required, the remaining allegations in  
28 this paragraph are denied.

1           34. As of the commencement of their Chapter 11 cases, VHS had  
2 accumulated substantial liabilities to DHCS, which administers Medi-Cal in  
3 California, for unpaid Hospital Quality Assurance Fees (“HQA Fees”), and for Medi-  
4 Cal fee-for-service overpayments.

5 **Answer: The allegations in Paragraph 34 contain legal conclusions or**  
6 **argument, to which no response is required. To the extent a further response is**  
7 **deemed required, the allegations in this paragraph are denied.**

8           35. On March 22, 2019, DHCS filed an objection to the proposed sale to  
9 SGM, arguing that the Medi-Cal provider agreements between it and VHS were  
10 “executory contracts” that could not be transferred free and clear of claims, interests,  
11 and encumbrances unless all defaults were cured, as required by Bankruptcy Code §  
12 365(b). Thus, according to DHCS, the provider agreements associated with each of  
13 the hospitals could not be transferred to SGM unless and until VHS cured the unpaid  
14 HQAF and fee-for-service overpayments. These claims totaled tens of millions of  
15 dollars. SGM had not agreed to assume responsibility for these claims and, pursuant  
16 to APA § 8.7, SGM was entitled to be released and discharged from any obligation to  
17 pay them.

18 **Answer: The allegations in Paragraph 35 contain legal conclusions or**  
19 **argument, to which no response is required. To the extent one is required, the**  
20 **allegations are denied.**

21           36. In response to DHCS’s objection to the sale, on April 10, 2019, VHS  
22 filed a brief in which it argued they did not need to cure defaults because the Medi-  
23 Cal provider agreements were non-executory contracts and could be transferred free  
24 and clear of DHCS’ claims.

25 **Answer: The allegations in Paragraph 36 contain legal conclusions or**  
26 **argument, to which no response is required. Plaintiffs admit that they filed a**  
27 **brief on April 10, 2019. The brief is a document that speaks for itself, and**  
28 **Plaintiffs deny any allegations that are inconsistent with the brief. To the extent**

1 a further response is deemed required, the remaining allegations in this  
2 paragraph are denied.

3 37. On May 2, 2019, the bankruptcy court entered its Sale Order authorizing  
4 the sale of the Hospitals to SGM free and clear of claims, liens, and encumbrances.  
5 However, the court did not rule on the dispute between VHS and DHCS regarding  
6 whether the provider agreements had to be treated as executory contracts. Instead,  
7 the Sale Order expressly carved out the Medi-Cal Provider Agreements from the  
8 released claims, liens, and encumbrances, stating:

9 Nothing in this Sale Order shall apply to Medical Provider  
10 Agreements until and unless there is a court order approving  
11 a settlement between the Debtors and the DHCS or a court  
12 order resolving the DHCS's objection.

(Docket No. 2306).

13 **Answer: The allegations in Paragraph 37 contain legal conclusions or**  
14 **argument, to which no response is required. Plaintiffs admit that bankruptcy**  
15 **court entered its Sale Order on May 2, 2019. The Sale Order is a document that**  
16 **speaks for itself, and Plaintiffs deny any allegations that are inconsistent with**  
17 **the Sale Order. To the extent a further response is deemed required, the**  
18 **remaining allegations in this paragraph are denied.**

19 38. On September 11, 2019, DHCS filed a Supplemental Brief regarding its  
20 unresolved objection to the sale of the hospitals free and clear of claims relating to  
21 the Debtors' Medi-Cal Provider Agreements. DHCS claimed that it was owed in  
22 excess of \$70 Million for unpaid HQA Fees and for reimbursement of fee for service  
23 overpayments which would have to be "cured" before the Provider Agreements could  
24 be transferred to SGM. In its renewed objection, DHCS stated:

25 Debtors' Medi-Cal Provider Agreements (hereafter,  
26 Agreements) are executory contracts that must be assumed  
27 and assigned to the Buyer. For the intended assumption and  
28 assignment to occur, either Debtors must pay all of the  
outstanding HQA Fees incurred before the closing of the  
sale or any outstanding I-IQA Fees on Debtors' account

1 must be paid by the Buyer through joint and severally  
 2 liability. In addition to the HQA Fee debt, Debtors and/or  
 3 the Buyer must also reimburse the Department for any  
 4 Medi-Cal overpayment and pay other debts owed to the  
 Department.

5 (Docket No. 3043).

6 **Answer:** The allegations in Paragraph 38 contain legal conclusions or  
 7 argument, to which no response is required. Plaintiffs admit that DCHS filed a  
 8 brief on September 11, 2019. The brief is a document that speaks for itself, and  
 9 Plaintiffs deny any allegations that are inconsistent with the brief. To the extent  
 10 a further response is deemed required, the remaining allegations in this  
 11 paragraph are denied.

12 39. VHS contested DHCS's characterization of the Medical Provider  
 13 Agreements as executory contracts. To that end, VHS once again argued that the  
 14 Provider Agreements could be transferred free and clear of any claims and liens  
 15 without compliance with Bankruptcy Code section 365. VHS also conceded it needed  
 16 to provide SGM with such a transfer to satisfy the APA.

17 **Answer:** The allegations in Paragraph 39 contain legal conclusions or  
 18 argument, to which no response is required. Plaintiffs admit that they filed a  
 19 document responding to DHCS's September 11, 2019 brief, which documents  
 20 speak for themselves, and Plaintiffs deny any allegations that are inconsistent  
 21 with these documents. To the extent a further response is deemed required, the  
 22 remaining allegations in this paragraph are denied.

23 40. On September 26, 2019, the bankruptcy court filed its Memorandum of  
 24 Decision in which it ruled that the Medi-Cal Provider Agreements could be  
 25 transferred without compliance with Bankruptcy Code § 365(b). However, the court  
 26 did not decide whether DHCS could retain its recoupment rights, which would have  
 27 allowed DHCS to recover its claims against VHS from monies otherwise payable to  
 28 SGM post-closing. Preservation of such recoupment rights would have prevented

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VHS from satisfying the condition in APA § 8.7, namely, that the provider agreements be transferred free and clear and that SGM be fully released and discharged of DHCS claims. In its Memorandum of Decision, the bankruptcy court expressly acknowledged that APA Section 8.7 obligated VHS to transfer the Provider Agreements free and clear of any DHCS claims of liability and that “the sale cannot close unless issues regarding alleged financial defaults existing under each Provider Agreement have been resolved.” (Dkt. No. 3146 at 3).

**Answer: The allegations in Paragraph 40 contain legal conclusions or argument, to which no response is required. Plaintiffs admit that on September 26, 2019, the bankruptcy court filed its Memorandum of Decision. The Memorandum of Decision speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the Memorandum of Decision. To the extent a further response is deemed required, the remaining allegations in this paragraph are denied.**

41. VHS lodged its proposed order with respect to the Memorandum of Decision on October 8, 2019. Despite the court’s clear statement that it was not deciding the recoupment issue, VHS lodged a proposed order seeking to prevent DHCS from recouping payments from future SGM receivables in connection with the transfer of the Medi-Cal Provider Agreements.

**Answer: The allegations in Paragraph 41 contain legal conclusions or argument, to which no response is required. Plaintiffs admit that it lodged a Proposed Order on October 8, 2019, that on November 13, 2019, which document speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the Proposed Order. To the extent a further response is deemed required, the remaining allegations in this paragraph are denied.**

42. The next day, on October 9, 2019, DHCS objected to VHS’s proposed order, arguing that, “the proposed order is not ‘consistent’ with the Memorandum [of

Decision]” and that “it overreaches by inserting gratuitous terms, to, for example, prohibit the Department’s recoupment after the sale.” (Docket No. 3330).

**Answer: The allegations in Paragraph 42 contain legal conclusions or argument, to which no response is required. Plaintiffs admit that on October 9, 2019, DHCS filed an objection, which speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the objection. To the extent a further response is deemed required, the remaining allegations in this paragraph are denied.**

43. On October 11, 2019, the bankruptcy court agreed with DHCS that VHS’s proposed order was overreaching. Contrary to VHS’s Proposed Order, the bankruptcy court stated, “the Memorandum Decision did not determine whether DHCS’ recoupment rights against SGM (if any) are extinguished by the transfer of the Provider Agreements free and clear of claims, interests, and encumbrances. (Docket No. 3372 at fn. 2).

**Answer: The allegations in Paragraph 43 contain legal conclusions or argument, to which no response is required. Plaintiffs admit that on October 11, 2019, the bankruptcy court entered an order, which speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the order. To the extent a further response is deemed required, the remaining allegations in this paragraph are denied.**

44. On October 11, 2019, the bankruptcy court entered an order that deleted the word “recoup” from the section providing for a transfer of the Medi-Cal Provider Agreements free and clear of claims, and expressly stated that it was reserving the issue of DHCS’s recoupment rights against the Debtors and SGM for future adjudication. Specifically, the bankruptcy court stated:

Provided, however, that nothing in this paragraph shall be construed to limit whatever rights DHCS may or may not have to withhold, under principles of equitable recoupment, payments owed by DHCS to the Debtors and or the SGM



Buyers, for the purpose of recovering alleged Pre-Transfer Effective Date Liabilities under or related to the Medi-Cal Program and/or HQAF Program.

(Docket No. 3372). The court thus left open the question of whether the Medi-Cal Provider Agreements could be transferred free of recoupment rights and the bankruptcy court did not make any further rulings on this issue before VHS demanded that SGM close on November 20, 2019.

**Answer: The allegations in Paragraph 44 contain legal conclusions or argument, to which no response is required. Plaintiffs admit that on October 11, 2019, the bankruptcy court entered an order, which speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the order. The APA speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. To the extent any other response is required, the allegations in this Paragraph are denied.**

**B. VHS Falsely Represents that It Satisfied the Conditions to Close and Improperly Demands that SGM Close the Sale On or Before December 5, 2019.**

45. On November 20, 2019, VHS, through its counsel of record Samuel Maizel of Dentons, sent SGM a letter falsely representing that VHS had satisfied all conditions to close as of November 19, 2019 and demanding that SGM close the sale by December 5, 2019 or be deemed in breach of the APA.

**Answer: The allegations in Paragraph 45 contain legal conclusions or argument, to which no response is required. Plaintiffs admit that on November 20, 2019, Plaintiffs' counsel sent a letter, which speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the letter. To the extent any other response is required. To the extent a further response is deemed required, the remaining allegations in this paragraph are denied.**

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46. Mr. Maizel's letter contained, at minimum, two misrepresentations with respect to VHS's satisfaction of APA Sections 8.6 and 8.7. First, Mr. Maizel falsely represented that section 8.6 of the APA had been satisfied. Mr. Maizel also suggested that Section 8.7 had been satisfied because VHS claimed: "Yesterday, as we notified you, the Debtors reached a settlement agreement with the United States, on behalf of Department of Health and Human Services and the Centers for Medicare and Medicaid Services, allowing for the transfer of the Medicare Provider Agreement without successor liability."

**Answer:** Plaintiffs admit that on November 20, 2019, Plaintiffs' counsel sent a letter. The letter is a document that speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the letter. On November 14, 2019, the Bankruptcy Court entered the *Order Granting "Debtors Emergency Motion for the Entry of an Order: (I) Enforcing the Sale Order Authorizing the Sale to Strategic Global Management, Inc.; (II) Finding That the Sale Is Free and Clear of Conditions Materially Different Than Those Approved by the Court; (III) Finding That the Attorney General Abused His Discretion in Imposing Conditions on That Sale; and (IV) Granting Related Relief"* [Doc. 3188] [Bankr. Docket No. 3611], thereby satisfying Section 8.6 of the APA. On November 19, 2019, Plaintiffs obtained a settlement with the Centers for Medicare and Medicaid Services, an agency of the United States Department of Health & Human Services, providing for the transfer of their Medicare Provider Agreements to SGM without successor liability, thereby satisfying their remaining obligations under Section 8.7 of the APA [Bankr. Docket No. 3680]. The foregoing documents speak for themselves, and Plaintiffs deny any allegations that are inconsistent with the foregoing documents. Further, Plaintiffs deny the remaining allegations in Paragraph 46, including allegations that contain legal conclusions or argument to which no response is required. To the extent a

1 further response is deemed required, the remaining allegations in this  
2 paragraph are denied.

3 47. Mr. Maizel's letter does not mention any settlement with DHCS with  
4 respect to the recoupment issue left open by the court's October 11, 2019 order.  
5 Indeed, no such settlement existed at the time (to the contrary, DHCS had appealed  
6 the court's order) and, thus, VHS knowingly and in bad faith misrepresented that all  
7 conditions to close had been satisfied.

8 **Answer: Plaintiffs admit that on November 20, 2019, Plaintiffs' counsel sent**  
9 **a letter, which speaks for itself, and Plaintiffs deny any allegations that are**  
10 **inconsistent with the letter. All other allegations in this paragraph contain legal**  
11 **conclusions or argument, to which no response is required. To the extent a**  
12 **further response is deemed required, the remaining allegations in this**  
13 **paragraph are denied.**

14 **C. SGM Notifies VHS of Its Failures.**

15 48. On November 22, SGM wrote two letters to VHS and advised it of its  
16 noncompliance with its obligations and conditions under the APA. SGM's letters set  
17 forth with specific detail that VHS had failed to satisfy numerous obligations under  
18 the APA, including, but not limited to: (1) VHS's failure to comply with legal  
19 requirements applicable to the conduct and operation of its hospitals, including, but  
20 not limited to, serious and material Health and Safety Code violations; (2) materially  
21 breaching APA sections 2.8, 2.10, and 4.6; (3) VHS's failure to obtain the approval  
22 of the Office of Statewide Health Planning and Development ("OSHPD") for the  
23 operation of several hospital facilities; (4) VHS's failure to satisfy the conditions of  
24 APA Section 8.7 with respect to the Medicare and Medi-Cal provider agreement  
25 transfers; (5) VHS's failure to satisfy the conditions of APA Section 8.6; (6) VHS's  
26 failure to respond to building and safety code violations and seismic compliance at  
27 St. Vincent and Seton hospitals or even to obtain the funds required to do so – thereby  
28 improperly shifting the costs to SGM; (7) other specifically enumerated regulatory

1 issues; (8) the substantial and material deterioration of the net patient revenue of the  
 2 hospitals; (9) fraudulently withholding information concerning serious health and  
 3 safety issues from SGM despite being legally obligated to disclose such conditions;  
 4 (10) the substantial and material impairment of accounts receivable; (11) VHS's  
 5 failure to reserve and to disclose its failure to reserve for its accrued obligations to  
 6 Independent Practice Associations, Health Plans and "Downstream Providers"; and  
 7 (12) VHS's incurrence of post-petition liability in violation of, *inter alia*, APA section  
 8 4.6(e).

9 **Answer: Plaintiffs admit that on November 22, 2019, SGM sent two letters,**  
 10 **which speak for themselves. All other allegations in this paragraph contain legal**  
 11 **conclusions or argument, to which no response is required. To the extent a**  
 12 **further response is deemed required, the remaining allegations in this**  
 13 **paragraph are denied.**

14 49. In addition to discussing VHS's noncompliance, SGM's November 22  
 15 letters specifically advised VHS that:

16 This letter shall also constitute further notice, pursuant to  
 17 APA section 8.4, of Verity's failure to perform certain  
 18 conditions, agreements and covenants, which Verity is  
 19 required to perform as a condition of SGM's obligation to  
 20 Close, and the failure to perform will result in a Material  
 Adverse Effect.

21 **Answer: Plaintiffs admit that on November 22, 2019, SGM sent two letters,**  
 22 **which speak for themselves. All other allegations in this paragraph contain legal**  
 23 **conclusions or argument, to which no response is required, or if required, are**  
 24 **denied.**

25 50. VHS refused to address the noncompliance issues identified in SGM's  
 26 November 22, 2019 letters. Instead, VHS wrote to SGM on November 25, 2019 and  
 27 offered excuses and equivocations for its noncompliance that had no merit. For  
 28

1 example, with respect to Section 8.7, VHS, again through its counsel Samuel Maizel,  
2 stated:

3 With respect to California Department of Health Care  
4 Services (“DHCS”), you acknowledge that the Debtors  
5 secured an Order [Docket No. 3372] from the Bankruptcy  
6 Court authorizing the transfer of the Medi-Cal Agreement  
7 free and clear of any interests asserted by DHCS, in addition  
8 to the Sale Order which terminated any creditor’s  
9 recoupment rights [Docket No. 2306]. Those Orders afford  
10 equal or greater protection to SGM than any settlement  
11 could have, thereby satisfying Section 8.7. In any event, a  
12 settlement with DHCS was reached on November 22, so  
13 there is no reason to debate this point further.

14 **Answer: The allegations in Paragraph 50 contain legal conclusions or**  
15 **argument, to which no response is required. Plaintiffs admit that on November**  
16 **25, 2019, Plaintiffs’ counsel sent a letter, which speaks for itself, and Plaintiffs**  
17 **deny any allegations that are inconsistent with the letter. To the extent any other**  
18 **response is required, the allegations in this Paragraph are denied.**

19 51. As set forth below, VHS’s newly concocted justifications with respect  
20 to its alleged satisfaction of Section 8.7 were also false. To wit:

- 21 (a) Despite falsely claiming otherwise in its November 20, 2019 letter, VHS  
22 had not, as of November 20, 2019, entered into a settlement agreement  
23 with DHCS which resulted in: (1) resolution of all outstanding financial  
24 defaults under any of VHS’s Medi-Cal Provider Agreements, and (2)  
25 full satisfaction, discharge and release of any claims under the Medi-Cal  
26 Provider Agreements, whether known or unknown that DHCS had  
27 against the seller or purchaser;
- 28 (b) Despite claiming otherwise in its November 25, 2019 letter, VHS, still  
did not have a binding agreement with DHCS even as of November 22;  
indeed, VHS’s counsel even acknowledged at a hearing on November

1 26, 2019, that it had not entered into a final settlement agreement with  
2 DHCS;

3 (c) Despite claiming otherwise, neither the bankruptcy court's order of May  
4 2, 2019 or October 11, 2019 provided SGM with the protection to which  
5 it was entitled under APA Section 8.7 because, *inter alia*, neither of  
6 those order eliminated DHCS' recoupment rights.

7 **Answer:** Plaintiffs admit that on November 25, 2019, Plaintiffs' counsel sent  
8 a letter. The letter is a document that speaks for itself, and Plaintiffs deny any  
9 allegations that are inconsistent with the letter. With respect to DHCS,  
10 Plaintiffs secured the DHCS Order [Bankr. Docket No. 3372] from the  
11 Bankruptcy Court authorizing the transfer free and clear of any interests  
12 asserted by DHCS, in addition to the Sale Order which terminated any  
13 creditor's recoupment rights [Bankr. Docket No. 2306]. Those Orders afforded  
14 equal or greater protection to SGM than any settlement could have, thereby  
15 satisfying Section 8.7 with respect to DHCS. SGM disagreed that the DHCS  
16 Order and the Sale Order satisfied Section 8.7. Consequently, although not  
17 necessary but given SGM's position, on November 22, 2019, Plaintiffs reached  
18 a settlement agreement with DHCS, which the Bankruptcy Court approved  
19 [Bankr. Docket Nos. 3786 & 3787]. On November 19, 2019, Plaintiffs obtained  
20 a settlement with the Centers for Medicare and Medicaid Services, an agency of  
21 the United States Department of Health & Human Services, providing for the  
22 transfer of their Medicare Provider Agreements to SGM without successor  
23 liability, thereby satisfying their remaining obligations under Section 8.7 of the  
24 APA [Bankr. Docket No. 3680]. The foregoing documents speak for themselves,  
25 and Plaintiffs deny any allegations that are inconsistent with the foregoing  
26 documents. Further, Plaintiffs deny the remaining allegations in Paragraph 51,  
27 including allegations that contain legal conclusions or argument to which no  
28

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1 **response is required. To the extent a further response is deemed required, the**  
2 **remaining allegations in this paragraph are denied.**

3 52. Indeed, VHS still had not entered into a settlement agreement with  
4 DHCS, as of December 5, 2019, the time VHS set for closing. Instead, VHS entered  
5 into an agreement with DHCS, *four days later*, on December 9, 2019. VHS's  
6 December 9, 2019 settlement with DHCS occurred *after* VHS had already breached  
7 the APA by demanding a false notice of closing for December 5, 2019, and thus,  
8 could not have satisfied VHS's obligations under Section 8.7 or provided a basis upon  
9 which VHS could demand that SGM close the sale. Even this belated agreement did  
10 not satisfy Section 8.7.

11 **Answer: Plaintiffs admit that on November 25, 2019, Plaintiffs' counsel sent**  
12 **a letter. The letter is a document that speaks for itself, and Plaintiffs deny any**  
13 **allegations that are inconsistent with the letter. The notice of closing is a**  
14 **document that speaks for itself, and Plaintiffs deny any allegations that are**  
15 **inconsistent with the notice of closing. With respect to DHCS, Plaintiffs secured**  
16 **the DHCS Order [Bankr. Docket No. 3372] from the Bankruptcy Court**  
17 **authorizing the transfer free and clear of any interests asserted by DHCS, in**  
18 **addition to the Sale Order which terminated any creditor's recoupment rights**  
19 **[Bankr. Docket No. 2306]. Those Orders afforded equal or greater protection**  
20 **to SGM than any settlement could have, thereby satisfying Section 8.7 with**  
21 **respect to DHCS. SGM disagreed that the DHCS Order and the Sale Order**  
22 **satisfied Section 8.7. Consequently, although not necessary but given SGM's**  
23 **position, on November 22, 2019, Plaintiffs reached a settlement agreement with**  
24 **DHCS, which the Bankruptcy Court approved [Bankr. Docket Nos. 3786 &**  
25 **3787]. On November 19, 2019, Plaintiffs obtained a settlement with the Centers**  
26 **for Medicare and Medicaid Services, an agency of the United States Department**  
27 **of Health & Human Services, providing for the transfer of their Medicare**  
28 **Provider Agreements to SGM without successor liability, thereby satisfying**

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1 their remaining obligations under Section 8.7 of the APA [Bankr. Docket No.  
2 3680]. The foregoing documents speak for themselves, and Plaintiffs deny any  
3 allegations that are inconsistent with the foregoing documents. Further,  
4 Plaintiffs deny the remaining allegations in Paragraph 52, including allegations  
5 that contain legal conclusions or argument to which no response is required. To  
6 the extent a further response is deemed required, the remaining allegations in  
7 this paragraph are denied.

8 53. As a result of VHS's numerous material breaches of the APA, on  
9 December 5, 2019, SGM sent VHS a letter notifying VHS that it was in material  
10 default of the APA and demanding the immediate return of its \$30 million deposit  
11 with interest pursuant to section 11.2 of the APA. In direct repudiation of its  
12 obligations, VHS refused to return SGM's \$30 million deposit. To the contrary, on  
13 December 6, 2019, VHS filed an "emergency motion for issuance of an order to show  
14 cause why SGM failed to close the sale by December 5, 2019." The bankruptcy court  
15 denied VHS's motion and expressly held that the parties would litigate issues  
16 concerning breach, and whether VHS must return SGM's \$30 million deposit in  
17 future litigation (i.e. this action).

18 **Answer:** Plaintiffs admit that on December 5, 2019, SGM sent a letter, which  
19 speaks for itself, and Plaintiffs deny any allegations that are inconsistent with  
20 the letter. Plaintiffs admit that on December 6, 2019, they filed a motion, which  
21 speaks for itself. The APA and bankruptcy court order speak for themselves,  
22 and Plaintiffs deny any allegations that are inconsistent with the APA or the  
23 bankruptcy court's order. All other allegations in this paragraph contain legal  
24 conclusions or argument, to which no response is required, or if required, are  
25 denied.

### 26 **III. VHS WRONGFULLY "TERMINATES" THE APA.**

27 54. Continuing with its bad faith strategy, on December 17, 2019, VHS, by  
28 and through its counsel of record, sent SGM a letter entitled "Notice of Termination

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Effective Date.” In VHS’s Termination Notice VHS states: “As you are aware, on November 25, 2019, November 27, 2019, and December 5, 2019, [VHS] sent [SGM] notices of SGM’s material breaches under the [APA] . . . .” VHS continued: “As a result of each of the above material breach notices, the APA will terminate effective December 27, 2019.” On January 3, 2020, VHS filed a Notice of the Termination of the APA with the bankruptcy court based on SGM’s alleged failure to close on December 5, 2019.

**Answer: Plaintiffs admit that on December 17, 2019, Plaintiffs’ counsel sent a letter, which speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the letter. Plaintiffs admit that on January 3, 2019, they filed a Notice of Termination, which speaks for itself. The APA speaks for itself, and Plaintiffs deny any allegations that are inconsistent with the APA. All other allegations in this paragraph contain legal conclusions or argument, to which no response is required. To the extent a further response is deemed required, the remaining allegations in this paragraph are denied.**

55. Since its wrongful termination and repudiation of the APA, VHS has continued to wrongfully withhold SGM’s \$30 million deposit, and refused all efforts by SGM to attempt to address the numerous problems created by VHS and to close the sale.

**Answer: Plaintiffs deny the allegations in Paragraph 55.**

**FIRST CAUSE OF ACTION**

**(Breach of Contract)**

**(All Counter-Defendants)**

SGM reasserts and incorporates herein by reference the allegations contained in Paragraphs 1 through 55 above.

**Answer: Plaintiffs incorporate their preceding responses to the allegations in the Counterclaims as if fully set forth herein.**

56. VHS and SGM entered into a valid contract, the APA.

**Answer:** Plaintiffs admit that Verity Health System, SGM and others entered the APA. All other allegations in this paragraph contain legal conclusions or argument, to which no response is required.

57. SGM has performed all of the terms and conditions required of it under the APA, except as excused by VHS's prevention of performance, breaches, and/or repudiation.

**Answer:** Plaintiffs deny the allegations in Paragraph 57.

58. VHS has materially breached the APA, including but not limited to by: (1) on November 20, 2019, demanding that SGM close the transaction despite the fact that VHS had not satisfied its obligations and conditions to closing; (2) failing to comply with legal requirements applicable to the conduct and operation of its hospitals; (3) failing to obtain the approval of the Office of Statewide Health Planning and Development ("OSHPD") for the operation of several hospital facilities; (4) failing to properly satisfy the conditions of APA Section 8.7 with respect to the Medicare and Medi-Cal provider agreement transfers and falsely representing that it had done so; (5) failing to satisfy the conditions of APA Section 8.6 and falsely representing that it had done so; (6) failing to respond to building and safety code violations and seismic compliance at St. Vincent and Seton hospitals; (7) violation of other specifically enumerated regulatory issues as set forth in the parties' correspondence; (8) allowing and precipitating the substantial and material deterioration of the net patient revenue of the hospitals; (9) allowing and precipitating the substantial and material impairment of accounts receivable; (10) failing to reserve and to disclose its failure to reserve for its accrued obligations to Independent Practice Associations, Health Plans and "Downstream Providers"; (11) incurring post-petition liability without accounting for such to SGM; and (12) wrongfully withholding SGM's \$30 million dollar deposit despite its multiple material breaches of the APA and its failure to satisfy the express conditions in the APA.

**Answer:** Plaintiffs deny the allegations in Paragraph 58.

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59. VHS has further breached the APA by repudiating the contract and refusing to perform thereunder, including, without limitation, by improperly terminating the agreement in its December 17, 2019 letter entitled “Notice of Termination Effective Date.”

**Answer: Plaintiffs deny the allegations in Paragraph 59.**

60. As a result of VHS’s breaches, SGM has sustained substantial harm in an amount to be proven at trial including, but not limited to, the wrongful retention of its \$30 million deposit and accumulated interest, additional out-of-pocket damages, including professional fees, in an amount in excess of \$13 million, plus substantial lost profits, and other damages resulting from VHS’s failure to comply with its contractual obligations.

**Answer: Plaintiffs deny the allegations in Paragraph 60.**

61. VHS’s breaches of the APA were a substantial factor in causing SGM’s harm.

**Answer: Plaintiffs deny the allegations in Paragraph 61.**

## **SECOND CAUSE OF ACTION**

### **(Breach of The Implied Covenant of Good Faith and Fair Dealing)**

(All Counter-Defendants)

SGM reasserts and incorporates herein by reference the allegations contained in Paragraphs 1 through 61 above.

**Answer: Plaintiffs incorporate their preceding responses to the allegations in the Counterclaims as if fully set forth herein.**

62. Implicit in the contract between SGM and VHS was a covenant that VHS would use its best efforts to give effect to the terms of the APA.

**Answer: Plaintiffs admit that the APA speaks for itself. All other allegations in this paragraph contain legal conclusions or argument, to which no response**

1 is required. To the extent a further response is deemed required, the remaining  
 2 allegations in this paragraph are denied.

3 63. This implied covenant required VHS to act in good faith at all times in  
 4 an attempt to ensure that SGM received the benefits of the APA.

5 **Answer: Plaintiffs admit that the APA speaks for itself. All other allegations**  
 6 **in this paragraph contain legal conclusions or argument, to which no response**  
 7 **is required. To the extent a further response is deemed required, the remaining**  
 8 **allegations in this paragraph are denied.**

9 VHS breached this implied covenant of good faith and fair dealing by deliberately  
 10 acting to deprive SGM of the benefits of the APA and by purposefully interfering in  
 11 the performance of the APA such that it materially harmed SGM. VHS did so  
 12 including by: (1) failing to comply with legal requirements applicable to the  
 13 conduct and operation of its hospitals; (2) failing to obtain the approval of the  
 14 Office of Statewide Health Planning and Development (“OSHPD”) for the  
 15 operation of several hospital facilities; (3) refusing to satisfy the conditions of APA  
 16 Section

17 64. with respect to the Medicare and Medi-Cal provider agreement  
 18 transfers; (4) failing to satisfy the conditions of APA Section 8.6; (5) failing to  
 19 respond to building and safety code violations and seismic compliance at St. Vincent  
 20 and Seton hospitals; (6) violation of other specifically enumerated regulatory issues  
 21 as set forth in the parties’ correspondence; (7) allowing and precipitating the  
 22 substantial and material deterioration of the net patient revenue of the hospitals; (8)  
 23 allowing and precipitating the substantial and material impairment of accounts  
 24 receivable; (9) failing to reserve and to disclose its failure to reserve for its accrued  
 25 obligations to Independent Practice Associations, Health Plans and “Downstream  
 26 Providers”; (10) incurring post-petition liability without accounting for such to SGM;  
 27 (11) wrongfully withholding SGM’s \$30 million dollar deposit; and (12) on  
 28 November 20, 2019, issuing to SGM an improper demand to close based on the false  
 representation that all closing conditions had been satisfied.

**Answer: Plaintiffs deny the allegations in Paragraph 64.**



65. As a result of VHS's breaches of the implied covenant of good faith and fair dealing, SGM has sustained substantial harm in an amount to be proven at trial including, but not limited to, the wrongful retention of its \$30 million deposit and accumulated interest, additional out-of-pocket damages, including professional fees, in an amount in excess of \$13 million, plus substantial lost profits, and other damages resulting from VHS's failure to comply with its obligations.

**Answer: Plaintiffs deny the allegations in Paragraph 65.**

66. VHS's breaches of the APA were a substantial factor in causing SGM's harm.

**Answer: Plaintiffs deny the allegations in Paragraph 66, including the subsequent WHEREFORE and PRAYER FOR RELIEF paragraphs.**

### **AFFIRMATIVE DEFENSES**

Plaintiffs plead the following Affirmative Defenses, which fully incorporate their preceding responses and prior Motions to Dismiss. Plaintiffs reserve the right to assert additional and further affirmative defenses based on information that may be provided during discovery or other investigation during the course of litigation.

#### **FIRST AFFIRMATIVE DEFENSE**

SGM fails to state a claim against Plaintiffs upon which relief can be granted. The Amended Counterclaims' allegations, and each purported cause of action alleged therein, are not pleaded with sufficient particularity, are uncertain, vague, and ambiguous, and fail to meet the applicable pleading requirements under federal law. SGM's Amended Counterclaims also fail to state facts or requisite intent supporting any claims for costs, interest, attorneys' fees, or special/consequential/punitive damages.

#### **SECOND AFFIRMATIVE DEFENSE**

The Amended Counterclaims are barred, in whole or in part, by the statute of frauds, as well as the doctrines of laches, estoppel, offset, waiver, consent, unjust enrichment, assumption of the risk, ratification, and accord and satisfaction.

**THIRD AFFIRMATIVE DEFENSE**

The Amended Counterclaims fail to the extent that SGM has failed to take reasonable steps to mitigate its claimed damages, and because SGM was actively at fault for its own alleged damages.

**FOURTH AFFIRMATIVE DEFENSE**

The Amended Counterclaims fail as a matter of law based on the full terms and conditions of the parties' contractual agreements, including, but not limited to, the conditions to closing and sale. Plaintiffs fully or substantially performed under the material terms of the contractual agreements (or Plaintiffs' performance was waived), but SGM did not, even though all conditions precedent to SGM's performance occurred or were waived and SGM's performance was not waived.

**FIFTH AFFIRMATIVE DEFENSE**

The Amended Counterclaims are barred because SGM and/or its affiliates first materially breached and repudiated the parties' contractual agreements, as detailed in Plaintiffs' First Amended Complaint, including, among other things, refusing to close the sale under the APA despite the fact that Plaintiffs had satisfied, waived, or otherwise fulfilled all conditions precedent to close, levying meritless and irrelevant accusations against Plaintiffs to avoid closing, misrepresenting its ability to perform under the APA, and making demands that are inconsistent with the terms of the APA.

**SIXTH AFFIRMATIVE DEFENSE**

The Amended Counterclaims are barred by the doctrines of unclean hands and bad faith, and they were filed only in response to Plaintiffs' legitimate and proper demands for contractual performance.

**SEVENTH AFFIRMATIVE DEFENSE**

The Amended Counterclaims and each claim fail because SGM did not detrimentally rely on any statements or omissions of Plaintiffs.

**EIGHTH AFFIRMATIVE DEFENSE**

The Amended Counterclaims and each claim fail because Plaintiffs are prohibited from returning SGM's \$30 million deposit by court orders, and Plaintiffs are not obligated to engage in an illegal transaction or to perform under an illegal contract.

#### **NINTH AFFIRMATIVE DEFENSE**

The Amended Counterclaims' claims for punitive damages, to the extent they still exist, are barred and should be stricken because the Amended Counterclaim contains no tort claim, such an award would violate Plaintiffs' rights guaranteed under the California and United States Constitutions, including, without limitation, the Equal Protection and Due Process provisions of the Fifth and Fourteenth Amendments of the United States Constitution, and the Excessive Fines provision of the Eighth Amendment of the United States Constitution.

#### **TENTH AFFIRMATIVE DEFENSE**

The Plaintiffs have alleged that Kali Chaudhuri is the alter ego of SGM. In the alternative, SGM lacks standing to seek return of the \$30 million deposit because it was paid by Kali Chaudhuri and not by SGM.

#### **PRAYER FOR RELIEF**

WHEREFORE, Plaintiffs pray for judgment for themselves and against SGM as follows:

1. Damages in an amount to be proven at trial;
2. For reasonable attorneys' fees;
3. For costs and expenses incurred herein, as well as pre- and post-judgment interest; and
4. For such other and further relief as the Court may deem just and proper.

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Respectfully submitted,

Dated: November 2, 2020

DENTONS US LLP  
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By /s/ Sonia Martin  
Sonia Martin

Attorneys for Verity Health Systems of  
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