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El Segundo, CA 90245

August 21, 2018

Wendi A. Horowitz, Deputy Attorney General  
Office of the Attorney General  
State of California, Dept of Justice  
300 S Spring Street, Suite 1702  
Los Angeles, CA 90013-1256

Re: Verity Health System of California, Inc.

Dear Ms. Horowitz:

As we discussed by telephone on August 17, 2018, Verity Health System of California, Inc. ("Verity") is hereby requesting a modification to, and amendment of, certain of the terms and conditions imposed by the Attorney General in its December 3, 2015 conditional consent to the change in governance and control of the Daughters of Charity Health System. Specifically, Verity is requesting a modification to the transaction as approved, which included, inter alia, that certain Health System Management Agreement ("Management Agreement") with Integrity Healthcare, LLC.

As you are aware, in 2015, the Daughters of Charity Health System ("DCHS") completed a reorganization and was renamed Verity Health System of California, Inc. Concurrent with the reorganization, BlueMountain Capital Management, LLC ("BlueMountain") created Integrity Healthcare, LLC ("Integrity") to provide management services to Verity. DCHS, BlueMountain and Integrity executed a Restructuring and Support Agreement on or about July 17, 2015.

As part of the transaction, Verity and Integrity entered in to the Management Agreement, which has a 15-year term, commencing December 14, 2015 and running through December 13, 2030. The Management Agreement provides Integrity with very broad contractual authority to manage Verity. *See, e.g.*, Management Agreement Sections 1.1 through 1.6 (and particularly sections 1.4 and 1.5). Pursuant to the Management Agreement, as modified by an Amendment, Integrity provides Verity with a (i) Chief Executive Officer (ii) Chief Operations Officer and President (iii) Director of Medical and Clinical Affairs and (iv) Chief Financial Officer. Integrity does not employ any other officials for Verity, and apparently, provides no other specific personnel to support Verity. As I understand it, essentially all services provided by Integrity to Verity are provided through these four individuals.

In exchange for providing the management services, Verity is obligated to make substantial payments to Integrity through a complicated management fee formula. Since 2015, Verity has recorded total management fees of approximately \$151.8 million through June 30, 2018, of which \$85.9 million was deferred and unpaid.

The Management Agreement can be terminated as set forth in Section 5.4.1:

"Absent Cause" under Section 5.2, Health System may terminate this Agreement at any time within 90 days' prior written notice to Manager . . . provided that Health System shall pay to Manager: (i) all Manager Compensation (including any interest accrued thereon) and other fees or reimbursable expenses accrued and payable to the Manager prior to the effective date of termination; and (ii) a termination fee equal to the present value of the Manager Compensation that, in the absence of termination of the Agreement will be payable to Manager from the day of the Notice of Termination through the remainder of the Initial Term exclusive of any Renewal Term (the "Termination Fee").

Following the Restructuring and Support Agreement and related transactions, NantWorks, LLC ("NantWorks"), acquired from BlueMountain the option to purchase certain former DHCS assets. NantWorks also acquired a 90% ownership interest in Integrity.

In connection with the approval of the DCHS reorganization, the Attorney General imposed conditions upon the transaction, as set forth in the Attorney General's letter dated December 3, 2015. Of note, and most critically for purposes of this request, the Management Agreement cannot be modified or rescinded without first providing the Attorney General 60 days' advanced notice of the proposed modification or rescission:

The transaction approved by the Attorney General consists of the System Restructuring and Support Agreement dated July 17, 2015, Amendment No. 1 to System Restructuring and Support Agreement, and any agreements or documents referenced in or attached to as an exhibit or schedule and any other documents referenced in the System Restructuring and Support Agreement and Amendment No. 1 to System Restructuring and Support Agreement including, but not limited to:

\* \* \*

b. Health System Management Agreement with Integrity Healthcare, LLC;

\* \* \*

All the entities listed in Condition I, Integrity Healthcare, LLC, a Delaware limited liability company, BlueMountain Capital Management, LLC, a Delaware limited liability company, and any other parties referenced in the above agreements shall fulfill the terms of these agreements or documents and shall notify and obtain the Attorney General's approval in writing of any proposed modification or rescission of any of the terms of these agreements or documents. Such notifications shall be provided at least sixty days prior to their effective date in order to allow the Attorney General to consider whether they affect the factors set forth in Corporations Code section 5917 and obtain the Attorney General's approval.

*(emphasis added).*

In addition, pursuant to the July 17, 2015 conditional approval, any transfer of control or management requires 60 days' notice to the Attorney General:

For 15 years from the closing of the System Restructuring And Support Agreement, [each hospital] and all future owners, managers, lessees, licensees, or operators of [each hospital] shall be required to provide written notice to the attorney general 60 days prior to entering into any agreement or transaction to do any of the following:

\* \* \*

(b) transfer control, responsibility, management or governance of [each hospital]. The substitution or addition of a new corporate member or members of [each hospital] or Verity Health System of California, Inc., the transfers for control of, responsibility for or governance of [each hospital] shall be deemed a transfer for purposes of this Condition.

Since entry in to the Management Agreement and imposition of the Attorney General's condition, Verity has experienced an unprecedented change in circumstances, facing tremendous, unexpected economic difficulties. Despite its extensive efforts to curb expenses and operate efficiently, Verity is now in a position where continued operation under the existing Management Agreement is economically impossible. As described above, a substantial amount of the fees owed under the Management Agreement remain deferred and unpaid. Further, given the virtual elimination of the role of BlueMountain, the current management structure is unnecessary.

Verity has determined that the most efficient and effective solution for ongoing operations is for it to terminate the Management Agreement and directly retain and employ the individuals currently providing management services to it pursuant to the Management Agreement with Integrity, namely, the (i) Chief Executive Officer, (ii) Chief Operations Officer and President, (iii) Director of Medical and Clinical Affairs and (iv) Chief Financial Officer.<sup>1</sup> By bringing these positions in-house, with management services provided directly by Verity employees, Verity believes it can reduce the financial strain facing the health system, while ensuring the continuity in management for Verity, to the benefit of our non-profit hospitals, patients, employees and the communities we serve. Put another way, Verity can receive the benefit of maintaining an ongoing (employment) relationship with the current executive management team without detrimentally impacting hospital operations or access to care, while eliminating significant costs.

When the Attorney General imposed the condition related to the Management Agreement, it was unforeseen that (a) the economics of Verity's operations would make the Management Agreement economically infeasible, and (b) BlueMountain would sell its position, making the requirement of the Management Agreement unnecessary. As such, we believe this amendment should be approved by the Attorney General's office as a reasonable modification to the conditions given the significant change in circumstances experienced by Verity and the tremendous benefit it will offer the system by maintaining the management team but reducing substantially the associated cost.

For these reasons, Verity requests that the Attorney General approve Verity's request to terminate the Management Agreement and cease using any outside management company.

Very truly yours,



Elspeth D. Paul  
General Counsel

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<sup>1</sup> The Integrity CFO resigned on August 18, 2018. As an interim measure, Verity's Senior Vice President of Finance is providing services as the Acting CFO. Through this submission, Verity also requests that the Attorney General recognize and approve this interim measure.