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March 9, 2015

Sent by Internet and U.S. Mail
Troy A. Schell
General Counsel
Prime Healthcare Management, Inc.
3300 E. Guasti Road
Ontario, CA 91761

RE: Proposed Change in Governance and Control of Daughters of Charity Health System

Dear Mr. Schell:

This letter responds to your client's request made at the March 5, 2015, meeting between the Office of the Attorney General's staff and you, Dr. Prem Reddy, Dr. Kavitha Bhatia, Mike Sarian, and Alan Smith. This meeting followed the Attorney General's Decision issued on February 20, 2015, that gave the Attorney General's conditional approval of the Daughters of Charity Health System's request to enter into a Definitive Agreement with Prime Healthcare Services, Inc. and Prime Healthcare Foundation, Inc. (collectively Prime) and to transfer control and governance of the Daughters of Charity Health System and its affiliated entities (collectively Daughters) to Prime. This meeting also comes after numerous discussions and correspondence between Prime and our office regarding this proposed transaction.

For the first time at the March 5, 2015 meeting, Prime's representatives communicated to the Attorney General's staff that the imposition of the ten-year conditions to provide essential health care services to the community at certain Daughters' health care facilities were "deal breakers" and that Prime does not therefore intend to close on the proposed transaction as set forth in the Definitive Agreement unless the Attorney General amends all of the ten-year conditions by reducing them to five years.

As you know, once the Attorney General conditionally consents to a transaction, California Code of Regulations, title 11, section 999.5, subdivision (h), provides that a party to the transaction may seek an amendment of the terms and conditions, but that "[t]he sole basis for such a request shall be a change in circumstances that could not have reasonably been foreseen at the time of the Attorney General's action."

This means that if Prime fulfills the Definitive Agreement, pursuant to section 999.5(h) the Attorney General will consider future requests for amendments to the conditions based on any reasonably unforeseen changes in circumstances. However, for the reasons explained below,

Prime's request to amend the ten-year conditions at this time would be inconsistent with subdivision (h), and we therefore decline to amend the ten-year conditions to five-years as set forth in the Attorney General's Decision.

First, Prime has had notice of the ten-year conditions since December 24, 2014, almost two months before the Attorney General's conditional approval of the transaction on February 20, 2015. These conditions were recommended by an independent health care expert. On December 24, 2014, the Health Care Impact Statements prepared by our expert that included the ten-year conditions were posted on our public website for review. On December 24, 2014, the Attorney General's staff contacted Prime's and Daughter's representatives directly to notify them of the Health Care Impact Statements being made public and asking whether any of the conditions contained therein would be a "deal breaker."

Prime responded on January 2, 2015, stating, "[o]verall, Prime Healthcare is in agreement with the vast majority of the conditions provided for each of the hospitals." While Prime communicated that it desired to explore the ten-year requirement with our office, it was not raised as an issue that would lead it to not close on the proposed transaction, or in Prime's subsequent letters dated January 19, 2015, and February 1, 2015. In those letters, Prime raised other concerns, including the Medi-Cal Program, the 1206(d) clinics, and acute rehabilitation services. These and other concerns were considered and addressed in the Attorney General's conditional approval of the transaction. But at no time prior to the conditional approval did Prime communicate in writing that operating the four hospitals as acute care hospitals for ten years would cause it to not fulfill the Definitive Agreement.

In addition to Prime's written communications, our office has had several conference calls and meetings with Prime to discuss these conditions prior to the Attorney General's February 20, 2015 conditional approval of this transaction. Similarly, in none of those calls or meetings did Prime state that the ten-year conditions would prevent it from closing the proposed transaction.

In sum, despite giving Prime a number of opportunities to identify the ten-year conditions as a "deal breaker" over the nearly 8-week period between the publication of our expert's recommendations and the Attorney General's conditional approval on February 20, 2015, Prime waited until after the conditional approval to inform the Attorney General's office it would not close on the transaction unless the ten-year conditions are amended to five-year conditions.

Second, in its post-conditional approval communications with this office, Prime's representatives have failed to provide new information demonstrating either (a) that previously undisclosed circumstances exist demonstrating that a ten-year condition on health services is not essential to these communities or (b) that Prime for some reasonably unforeseen reason is unable to provide these essential health services to these communities for a period of ten years.

As noted above, the ten-year conditions were recommended by an independent health care expert. The resulting Health Care Impact Statements set forth the essential role that the four hospitals and Seton Coastside provide to the communities they serve. As an example, St. Francis Medical Center has the largest market share of inpatient discharges in its service area. Our consultant, representatives of Federally Qualified Health Centers, Los Angeles County and community representatives all opined that it was essential for St. Francis Medical Center to retain all or most of the services it currently offers. O'Connor Hospital was noted to be a safety-net provider of healthcare services and Saint Louise Regional Hospital provides vital services to the community. Seton Medical Center and Seton Coastside were also found to be important safety-net providers of acute and long-term care for the community; Seton Coastside was the only provider of 24-hour "standby" emergency services along the 55- mile stretch between Santa Cruz and Daly City.

The ten-year condition was also based in part on Dr. Reddy's own statements at the public meetings and in the referenced letters above: Prime plans on operating the hospitals long term; it had never closed a hospital nor terminated an essential service line; and it had successfully exceeded all of the conditions imposed by the Attorney General in prior transactions.

Under Corporations Code section 5914 *et seq.*, the Attorney General has the authority to impose these ten-year conditions as part of her approval of the proposed transaction. Because each health facility transaction is unique, the statutory and regulatory scheme provides the Attorney General with complete discretion to impose conditions for periods of time longer than the minimum of five years. Specifically, Code of Regulations, Title 11, section 999.5, subdivision (f)(8)(C) states:

> It is the policy of the Attorney General, in consenting to an agreement or transaction involving a general acute care hospital, to require for a period of at least five years the continuation at the hospital of existing levels of essential healthcare services, including but not limited to emergency room services. *The Attorney General shall retain complete discretion to determine whether this policy shall be applied in any specific transaction under review* [emphasis added].

As described above, and in the Health Care Impact Statements, the conditions to operate St. Francis Medical Center, O'Connor Hospital, St. Louise Regional Hospital and Seton Medical Center as acute care facilities for ten years and Seton Coastside as a licensed skilled nursing facility for ten years are of vital importance to the communities served by these facilities. Having failed to identify a change of circumstance as required by section 999.5(h), Prime's newly raised-request to amend the majority of ten-year conditions and reduce them to five years cannot be granted at this time. [1]

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[1] In addition to Prime's concerns about the ten-year conditions, in the February 27, 2015 letter, you assert that the conditions regarding Medi-Cal managed care contracts did not include Prime's proposed language that the contracts be negotiated on terms provided by "similarly

(continued...)

Please let me know if you have any further questions. [2]

Sincerely,

TANIA M. IBANEZ
Senior Assistant Attorney General

For KAMALA D. HARRIS
Attorney General

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situated hospitals offering the same or similar set of services." This assertion is erroneous. Our conditions all state that the health facilities are required to maintain and have Medi-Cal Managed Care contracts "on the same terms and conditions as other similarly situated hospitals offering substantially the same services." (See St. Francis- Condition VII; St. Vincent-Condition VI; O'Connor- Condition VI; Saint Louise -Condition VIII, and Seton Medical Center and Seton Coastside- Condition VII.)
In that same letter you also raise concerns about the community benefit services and charity care amount conditions. But, at the meeting on March 5, 2015, Dr. Reddy indicated that he is no longer concerned about the Attorney General's conditions related to community benefit services or the charity care.

[2] As communicated in our March 5, 2015 meeting, we can clarify any conditions in the Attorney General's conditional approval of the transaction, to the extent that any are ambiguous or subject to different interpretations.