

**BlueMountain/Integrity Healthcare/Verity Health System
Questions and Answers
August 12, 2015**

1. What is the difference between BlueMountain, Integrity Healthcare, and Verity Health System?

Who is Verity Health System? At completion of the transaction (which means we have received Attorney General approval), the hospitals, Medical Foundation and other DCHS subsidiaries will become members of Verity Health System ("Verity"), an independent, non-religious, non-profit healthcare system governed by a newly formed independent board of directors. Verity Health System is simply the new name of the health system that is replacing DCHS. The new, independent board will control Verity Health System and all existing DCHS board members will resign at the completion of the transaction.

Who is Integrity Healthcare? Integrity Healthcare LLC ("Integrity") is a newly formed healthcare management services company owned and controlled by BlueMountain. Integrity will provide management services and operational support to Verity Health System under a Management Services Agreement for a minimum of 15 years. Integrity Healthcare will also manage certain other acute healthcare facilities that BlueMountain acquires in the future in CA.

Who is BlueMountain? BlueMountain Capital Management LLC ("BlueMountain") is a private investment management company that manages approximately \$21 billion of assets. BlueMountain is an established investor throughout the country in healthcare facilities and healthcare services. BlueMountain will provide significant new capital investment into Verity Health System. As described above, BlueMountain owns Integrity and will sit on the board of Verity Health System. BlueMountain owns an option to convert Verity Health System to a for-profit health system from year three through year 15.

2. Can you explain how this transaction is structured?

There are three pieces.

- a) **New Affiliation/Board of Directors:** The existing religious non-profit public benefit corporation (DCHS) is being restructured into a non-religious, non-profit, public benefit corporation (renamed Verity Health System) with a new Board of Directors. The existing board

will resign at the completion of the transaction and will cease to be involved. Local Boards, however, will remain over time, and may change over time as circumstances warrant.

b) **New Operator:** On July 17, DCHS entered into a transitional services agreement with Integrity Healthcare to begin the transition period, bringing Integrity's expertise and resources to the system. A Management Services Agreement will be entered into between Verity Health System and Integrity Healthcare at the completion of the transaction (expected to be in November/December).

c) **New Financial Capital Provider:** BlueMountain will provide an initial \$100 million contribution to Verity Health System. BlueMountain is committing to lend Verity Health System up to \$160 million at completion of the transaction to be used for turnaround efforts. As a part of the transaction, BlueMountain will have an option to convert Verity Health System to a for-profit system anytime from year three through year 15.

As background, from a legal perspective, there is no private owner of a non-profit corporation. The hospitals, Medical Foundation and other DCHS entities will be affiliates within the newly named Verity Health System after this transaction is successfully completed. A new board will be created at Verity Health System that will be independent of the Daughters of Charity, and have responsibility for overseeing the management agreement between Integrity and Verity Health System. To reiterate, the Daughters of Charity will not be involved in Verity Health System after the completion of the transaction. The new, independent board will have responsibility for overseeing the management agreement between Integrity and Verity.

3. Will the Daughters of Charity have a role after the transaction closes?

Verity Health System will no longer have a dedicated religious affiliation. The Daughters of Charity will no longer have oversight or management responsibility of Verity Health System or any of the hospitals once the transaction closes.

4. How will the new independent board be selected?

BlueMountain and Integrity Healthcare will recommend a slate of new board members to the parent company of DCHS, Daughters of Charity Ministry Services Corporation (DOCMSC). DOSMSC will then approve and appoint the new board members from the pool of candidates who were recommended. BlueMountain will have one representative from their company on the board, which will be comprised of not less than five members. The current DCHS Board of Directors will be entirely replaced by the new board. This will occur immediately after the transaction is completed. Local hospital boards of directors will also be reconfigured.

5. Where does up to \$260 million capital come from? Is \$260 million going to be enough?

BlueMountain commits to provide up to \$260 million at the completion of the transaction in two pieces. The first \$100 million in the form of a contribution, and another up to \$160 million in the form of a debt commitment. This capital, coupled with a strong focus on continued operational improvement, strategic growth initiatives and new physician integration strategies, should be sufficient to stabilize and strengthen the hospitals, Medical Foundation and other entities. This is money we can start using right away for new equipment, building and seismic upgrades, physician growth initiatives, new services, new marketing campaigns and more. It's what we need to ensure the future. This large infusion of capital will provide a great jump start on the many strategic, operational and capital initiatives in the pipeline. Each one of us is responsible for doing our jobs well to ensure our future. In addition to the capital injected by BlueMountain, when we are successful in our turnaround, ongoing earnings will be generated from operations that can be used for improvements and growth.

6. What will happen if BlueMountain decides in three years that it does not want to convert the hospitals to for-profit?

BlueMountain has the option to convert Verity Health System to a for-profit entity starting in three years. This conversion option exists until the end of 2030. If BlueMountain does not exercise the option to convert the system to for-profit in the next 15 years, Verity Health System would continue to exist as a non-profit and Integrity Healthcare will continue to manage and operate Verity Health System as a non-profit hospital system under the direction of its independent Board of Directors. BlueMountain expects to exercise the option if Verity Health System achieves its goals and it makes economic sense to convert to a for-profit entity.

7. Why didn't BlueMountain simply convert the health system to a for-profit system today?

- a) First, a conversion of a non-profit entity to a for-profit entity can entail several costs and would be too disruptive to the health system currently.
- b) A for-profit conversion would also require the refinancing of existing tax-exempt debt. After the capital injection and ensuing stabilization of operations, the system will have better access to the capital markets.
- c) In addition, a for-profit conversion changes the ongoing tax status of the health system and it would become an ongoing payer of income taxes and property taxes. These are additional expenses the system does not have the flexibility to bear currently.

Given the lack of current financial stability within DCCHS, the Board of Directors felt it would be most beneficial to take in a large injection of capital and new leadership while continuing with the current non-profit structure. The DCCHS board considered a number of offers from well-qualified bidders and

determined that the bid from BlueMountain was superior due to operational stability, the additional capital resources and experienced management that will put the hospitals, Medical Foundation and other DCHS entities in a stronger position, both financially and strategically. BlueMountain will have 15 years to consider the costs and benefits of converting Verity Health System to a for-profit entity.

8. Why is BlueMountain comfortable making this investment?

BlueMountain is willing to commit capital to Verity Health System because it believes in the success of the turnaround efforts and the future of Verity Health System. BlueMountain is the owner of the management company (Integrity Healthcare) and therefore has a vested interest in ensuring the continued success of Verity Health System. Lastly, BlueMountain is committed to ensuring that its capital is not at significant risk of loss. The up to \$260 million capital injection and leaders with tremendous turnaround experience help avoid this. BlueMountain and Integrity are committed to ensuring the success of Verity Health System. There are many financially successful non-profit hospitals with stable operating environments, and if Verity Health System remains non-profit it can still financially thrive and be in existence well beyond the next 15 years.

9. Describe the Management Services Agreement and any associated fees?

Through a 15-year Management Services Agreement, Integrity will oversee and direct activities designed to improve the financial and operational well-being of the hospitals and Medical Foundation, including the day-to-day operations. This includes everything from financial management to quality assurance and facility improvements. The base management fee is 1% of total net revenue per year. There are specific cash reserves, liabilities and capital expenditures that must be met before additional fees can be paid. More specifically, an additional 1% can be paid per year for meeting certain cash reserve targets, and an additional 2% per year can be paid after achieving the turnaround and satisfying ongoing liabilities of the health system. In any event, a large portion of Integrity Healthcare's management fees are subordinate to (or to be paid after) other system payments, such as capital expenditures and debt payments, and rely on improving results and returning the health system to a positive margin. The existing DCHS Board of Directors felt that the structure of this transaction aligned interests for all stakeholders.

10. Is any real estate being sold in the transaction?

Currently, there are no plans to sell real estate. In the future, any decision to sell real estate would be decided by the Verity Health System Board of Directors, and any proceeds from the sale would return to Verity Health System to pay for system initiatives and programs.

11. Would BlueMountain accept the same conditions that were placed on Prime?

The structure of the transaction is substantially different from the Prime transaction. We expect to continue productive conversations with all stakeholders, including the Office of the Attorney General, to reach a successful conclusion that positions Verity Health System as a key provider of healthcare in several important regions of California. We are confident that all stakeholders, including the AG, will work constructively to ensure the stability and transition of the health system into new hands.

12. Will a new management team replace Robert Issai and other staff at DCHS?

A new management team, led by Mitch Creem and Mark Meyers, will assume responsibility upon completion of the transaction. Mr. Creem and Mr. Meyers and the entire Integrity team bring first-hand experience in driving organizational turnarounds and expertise in health system management. In addition to several operational improvement plans, a new business development and physician alignment strategy will be implemented with clinical leadership provided by Integrity. Integrity Healthcare and BlueMountain representatives will be spending time in the facilities in the coming weeks and months and are excited to get to work. The transition period has just begun and several performance improvement initiatives are underway to ensure positive change. After the completion of the transaction, there may be several months of transition as other senior leadership decisions are made. As previously stated, Verity Health System expects to retain substantially all of the employees of DCHS.

13. How does this transaction impact our physicians?

Physicians are key to transforming healthcare for the better, and they are key to this turnaround. Investments in clinical programs, clinical expansion and new affiliations will be at the core of each hospital's market strategy. Integrity will be working closely with physicians on growth initiatives and to create better physician alignment in each market. In addition, physicians will be intimately involved in helping to improve the patient care operations in each hospital. Documentation improvements and length of stay improvements are already happening in the hospitals. Physicians should begin seeing improvements at the facilities due to the infusion of much needed capital, which in turn should help them continue to provide excellent care.

14. What will happen to the union contracts?

Verity Health System will assume all union contracts in their current form at completion of the transaction. Management teams will then work together with union leadership to create new contracts for the future. Verity Health System has committed to work collaboratively with the unions.

15. Does Attorney General Kamala Harris need to approve the transaction?

Yes. California law requires the Attorney General's review and consent of this transaction. DCHS submitted its application to the Attorney General on July 31, 2015. The Attorney General has 105 days for review and approval. Public hearings may occur the end of September - early October, and we hope this transaction will be formally completed in November or early December. Interaction with the Attorney General's office to date has been constructive.

16. Do you anticipate more cost-saving cuts in addition to those made over the past months?

There's much more that needs to be done to increase revenue and reduce costs to ensure the long-term success of the health system. We are committed to restoring the health system to where it is indispensable in the markets it serves. Hospital management teams and Medical Foundation leadership are working to create action steps to ensure that high quality, safe and compassionate care is delivered to all members of the community. We want to make every effort to ensure that the transition is as smooth as possible with minimal operational disruptions. While cost controls are typical elements of all turnarounds, business development and revenue growth initiatives will also be important to ensuring the health system remains more relevant in the future. Operational turnaround plans being implemented in the hospitals are already making a positive impact.

17. Who will be responsible for the pension obligations going forward?

Verity Health System will be responsible for the pension obligations going forward. A portion of the funds provided by BlueMountain will help provide support which will allow these pension plans to be funded and allow conditions to exist such that benefit obligations can be paid in the future. The Church Plan pension will be converted to an ERISA pension plan.

18. Is there a commitment to keep all six of the hospitals open?

Yes. The Verity Health System business plan is premised on all six hospitals, the Medical Foundation and other DCHS entities remaining open to provide healthcare services to the communities they serve. Verity Health System is committed to keeping the emergency departments and trauma center open, maintaining charity care policies, spending at least \$180 million in capital improvements and upgrades, and won't restrict the type or level of medical services that may be provided at the hospitals after the transaction is completed. Verity Health System is committed to ensuring the hospitals remain viable and vibrant in the future.

19. How did BlueMountain get involved in this transaction?

BlueMountain is a significant participant across the healthcare spectrum, including acute and post-acute healthcare facilities. BlueMountain has maintained board level or a significant role in investments that include an acute care hospital system (Lifecare), medical products (Angiotech), and healthcare real estate (MedEquities). BlueMountain has made several direct investments in post-acute healthcare facilities and controls an entity that owns skilled nursing and rehabilitation facilities in states including California.