



May 21, 2014

CONFIDENTIAL

VIA EMAIL AND OVERNIGHT MAIL
BLigibel@HL.com

Daughters of Charity Health System
c/o Geoffrey Ligibel
Houlihan Lokey
123 N. Wacker Drive, 4th Floor
Chicago, IL 60606

VIA EMAIL AND OVERNIGHT MAIL
SJackson@HL.com

Daughters of Charity Health System
c/o Scott Jackson
Houlihan Lokey
123 N. Wacker Drive, 4th Floor
Chicago, IL 60606

Dear Geoff and Scott:

On behalf of Aeoro LLC (“Aeoro”), we submit this Proposal, including a marked-up form of Purchase Agreement (the “Offer”) for the proposed transaction described herein (the “Transaction”) between Aeoro, a Delaware LLC and newly formed subsidiaries and/or affiliates thereof (collectively, the “Aeoro”), and Daughters of Charity Health System (the “DCHS”).

The following Proposal is based on the information made available to Aeoro from the Confidential Information Memorandum, diligence documents and management interviews.

1. **Purchase Agreement.** Please see attached draft Asset Purchase Agreement, which is for discussion purposes only.

2. **Purchase Price.** Based on information made available to Aeoro by DCHS, and subject to the conditions set forth in this letter, Aeoro offers to acquire substantially all of the assets of DCHS and assume certain liabilities, at an enterprise value of Five Hundred Fifty Million Dollars (\$550MM), comprised of the following consideration:

(a) cash in the amount of Two Hundred Seventy-Five Million Dollars (\$275MM); plus

(b) assumption of DCHS’s liabilities under the Retirement Plan for Hospital Employees¹ and the “Church Plan,” in an amount not to exceed Two Hundred Seventy-Five Million Dollars (\$275MM).

¹¹Given that additional due diligence is required, the attached Asset Purchase Agreement excludes the RPHE liability, however, subject to satisfactory results, Aeoro would be willing to assume such liabilities.



This purchase price is based upon DCHS indication that it will not agree to: (i) survival of any Seller Representations and Warranties, (ii) a holdback, or (iii) post-closing indemnification obligations of DCHS. Aeoro values the additional assumption of this risk at approximately fifteen percent (15%) to forty percent (40%) of the total purchase price. As such, Aeoro has reduced its cash consideration component/offer by Fifty Million Dollars (\$50MM), or eight percent (8%) of the total purchase price.² Should DCHS reconsider representation and warranties survival and concomitant holdback, Aeoro is willing to adjust its purchase price accordingly.

3. Capital Expenditure Commitments. After the site visits and reviewing the physical plants, Aeoro confirms its commitment to make investments in property, plant equipment, technology and working capital to support the continued operations of all hospitals of the DCHS health system in the amount of *Three Hundred Million Dollars (\$300MM) over the next four to five years.*

4. Sources of Capital. This Transaction would be financed with a capital structure designed to provide management with the ability to achieve its operational and growth objectives, and flexibility to weather economic cycles, seasonal working capital needs and changes in business conditions. Transaction financing will be provided by League Park Ventures, with whom we have been working closely on the proposed Transaction. League Park Ventures has reviewed the Transaction internally with its investment committee and already *has preliminary approval to proceed with the Transaction.* Final approval will be subject to a mutually agreed upon Transaction structure and is expected to run concurrent to the due diligence process.

5. Plans with Respect to Collective Bargaining Agreements. DCHS acknowledges the impact of the current Collective Bargaining Agreements on all prospective Buyers' transaction valuations. Renegotiation of all Collective Bargaining Agreements is imperative for and critical to the value proposition and growth opportunity of the DCHS assets, and Aeoro's assumptions related thereto.

Accordingly, Aeoro proposes to enter into negotiations with all Unions currently in the DCHS facilities between execution and Closing of the Purchase Agreement. Aeoro plans to engage all unions immediately after execution, with DCHS consent. In the event Aeoro is unable to successfully renegotiate the CBAs to its satisfaction by no less than thirty (30) days of the Closing Date, Aeoro proposes to arrange, in concert with DCHS, a pre-packaged or pre-arranged filing under the United States Bankruptcy Code in order to obtain court assistance in renegotiating the largest cost centers of the DCHS system.

²For avoidance of doubt, this reduction is already reflected in 2.a., above. Eight percent was calculated as percentage of total purchase price, as originally contemplated prior to reduction of cash consideration (i.e., based on the original offer of cash consideration in the amount of \$325MM).



The changes to the CBAs that Aeoro would seek are with respect to any covenants, agreements or provisions in the CBAs that limit the employer's rights generally and the employer's rights to manage its cost of labor specifically, as follows:

- Management rights to staff operations appropriately and cost effectively
- Management rights to flex and call-off appropriately and cost effectively
- Management rights to manage performance and discipline of rank and file employees
- Management rights as they relate to control and discretion over staffing decisions, generally
- Wage scales (we understand steps on all wage scales increased well in excess of the market rates during the last 5 years)
- Health and Welfare benefits (to a more reasonably priced plan and/or employee contribution/commitment to share in the burden)

Aeoro believes that it is uniquely qualified and experienced to manage this process to successful resolution. Aeoro is union tolerant and will not seek to de-certify the unions at the hospitals. Philosophically, Aeoro believes labor organization is an ordinary cost of doing business in traditional healthcare and believes hospital management must recognize the need to live side-by-side with organized labor. Each of the Aeoro executive staff members who would have bargaining team responsibility and/or decision-making authority has extensive experience with organized labor in both its management or in collective bargaining:

Roy Santarella, Chief Executive Officer – Roy has led organizations such as Stanford Medical Center and West Penn Allegheny through collective bargaining during periods of financial distress for both organizations, to great success. Roy is accustomed to making tough decisions while obtaining buy-in from the organized labor force. Roy's track record of negotiating with and fair treatment of an organized labor force can be easily researched, as his experience is with renowned organizations.

Mark Uffer, Regional President/Operations – Mark has been in healthcare for more than 35 years and has managed and worked with organized labor for decades. As Regional Chief Executive Officer on behalf of Prime Healthcare, Mark was able to transition and integrate St. Mary's Regional Medical Center



in Reno, Nevada from Dignity Health, a non-profit and traditionally union-friendly organization, to an organization known for its poor relations with organized labor, with as little disruption and employee dissatisfaction as possible. Such transition and integration on behalf of Prime Healthcare is a testament to Mark's skill, diplomacy, fairness and expert management in healthcare.

Sharyn Alcaraz, General Counsel– Sharyn has served as a Human Resources Director for a stand-alone safety net hospital and has participated as a management co-lead on three management bargaining units: (1) Alta Healthcare System, (2) AHMC Healthcare, Inc., and (3) Pacifica Hospital of the Valley. Sharyn's experience on the floor as an HRD was invaluable to developing a sensitivity that many other General Counsel, labor and employment counsel, and traditional labor counsel do not normally have. Her ability to manage and work firmly yet fairly with rank and file employees earned her the respect and a collegial and cooperative working relationship with Union Representatives for SEIU-UHW (Claudia, now the Union Representative for the largest Kaiser hospitals in Los Angeles County) and SEIU-121RN while at Pacifica Hospital of the Valley,³ and with union negotiators for SEIU-UHW (all of them traditional labor attorneys) while at AHMC Healthcare.

In addition, strategically Aeoro has retained Bob Millman of Littler Mendelson, who has a long resident history of representing DCHS in Union bargaining until relatively recently. Aeoro believes the continuity of legal representation on behalf the employer, the relationship between Mr. Millman and union representatives, and Mr. Millman's institutional knowledge of the history of organization and bargaining at all of the DCHS hospitals demonstrates Aeoro's commitment and determination to successfully work with the unions as partners. Finally, Aeoro believes that Mr. Millman, as outside legal representative, is a strategic addition to a management bargaining and decision-making team that is already strong with a rich combined history of working with, negotiating with, and managing an organized labor force.

6. Plans with Respect to Pension Plans. Subject to satisfactory due diligence review, Aeoro intends to assume DCHS's liabilities under the Retirement Plan for Hospital Employees (the "RPHE") and the "Church Plan," based on the assumption that the "underfunded liabilities" under the plans do not exceed Two Hundred Seventy-Five Million Dollars (\$275MM). It is unclear to Aeoro the liabilities (whether exclusively "underfunded

³While at Pacifica, Sharyn was part of a management team that was forced to make the difficult decision to file for protection under Chapter 11 of the United States Bankruptcy Code, due almost exclusively to unsustainability of the percentage of revenue that the cost of labor represented. Ultimately, the management team was able to impress upon the Unions the severity of the situation and what it meant to the survival of the hospital and fundamentally to all of the employees of the hospital. In the end, the CBAs were renegotiated, all while keeping intact the union presence, the materiality and essence of the CBAs, and minimizing job loss.



liabilities” or other) that comprise the RPHE, Church Plan and “Seller Plan” liabilities. (*See also* Section 7.b., below.)

7. **Further Due Diligence.** At this time, Aeoro contemplates conducting further diligence as follows. Aeoro reserves its rights to request and conduct additional diligence, or to supplement or modify this list as the needs arise:

- a. Seller’s and Hospitals’ policies and procedures regarding paid time off versus sick leave and accruals in each bank showing on the books of Seller/Hospitals, if any.
- b. Liabilities represented by: (i) the “Seller Plans,” as that term is defined in DCHS’ Form Asset Purchase Agreement, including, but not limited to the “top up” plans, and (ii) the RPHE. For example, Aeoro would want to understand whether the liabilities represented by the RPHE liabilities include a withdrawal liability. Aeoro would also like the opportunity to speak with the Board of Trustees of the RPHE (regarding its plans to assess a withdrawal liability against DCHS, or alternatives to such action), and Towers Watson, *etc.*
- c. For its own purposes in planning capital expenditure needs, Buyer would like to understand: (1) the assets held by Seller on behalf of the Foundation, and (2) all restricted and unrestricted cash and cash equivalents held by Seller.
- d. Aeoro will produce a list of further diligence requests related to Marillac Insurance Company, Ltd.

8. **Contingencies.** Aeoro anticipates the following Closing contingencies:

- a. **Due Diligence.** Satisfactory completion of our remaining due diligence.
- b. **Definitive Documentation.** Execution of definitive, mutually satisfactory Asset Purchase Agreement and other legal documentation.
- c. **Financing.** Receipt of the cash proceeds of the financing necessary to consummate the transaction contemplated hereby and to fund the ongoing working capital needs of the organization, on terms and conditions satisfactory to Aeoro. The process for securing the required financing will take place concurrently with the proposed due diligence timeframe.
- d. **Federal Trade Commission Approval.** Required based on the applicability thresholds of the Hart-Scott-Rodino Antitrust Improvements Act.
- e. **California Attorney General Approval.** Required for conversion of the system from a non-profit to for-profit organization. Aeoro does not anticipate opposition



from the public during the public hearings, as each of its management team members is non-controversial. Likewise, Aeoro does not anticipate objection by the Attorney General's Office, itself, or the California Department of Public Health, as each of Aeoro's management team members has no history of regulatory or compliance violations, or been involved in claims of Medicare fraud and abuse, or other fraudulent or unethical practices/conduct.

- f. Change of Ownership Application. Purchaser's receipt of government approval of the "CHOW," required for transfer of all hospital and facility licenses.
- g. Medicare Forms 855 and Other Enrollment Forms for Government Payors. Purchaser's receipt of government approval of the Forms 855 and like forms, required for the transfer of all government program provider numbers.
- h. Title Insurance. Purchaser's receipt of commitment from title company for title insurance coverage to Purchaser's satisfaction.
- i. Environmental. Purchaser's receipt of satisfactory reports, as may be requested by Purchaser.
- j. Renegotiation of Collective Bargaining Agreements. See Section 5, above.
- k. Marillac Insurance Company, Ltd. Aeoro's decision to acquire this asset is based on further diligence, as stated in Section 7.d., above.

9. Timing to Closing. Aeoro anticipates a Closing Date one hundred twenty (120) days after Effective Date or date of full execution (of the Asset Purchase Agreement).

10. Differentiated Characteristics of Purchaser.

a. Patient Care/Patient Satisfaction/Community Relationships. While the executive management team members have not owned hospital operations previously, the key members have a deep and extensive operational history with well-known and respected hospitals and hospital systems, all of which are known for their quality of patient care, patient satisfaction, and relationships with their communities and physicians.

Roy Santarella is a former Chief Operating Officer for Mercy Health System (now Catholic Health Partners), the former Chief Financial Officer for Stanford Medical Center and the former Chief Administrative Officer for West Penn Allegheny Health Systems – each of which are known for their clinical and quality excellence.

Mark Uffer has been in hospital operations for more than 35 years. He has served as a Chief Executive Officer and Chief Operating Officer within the Tenet System, including St. Luke in the Greater San Gabriel Valley of Los Angeles County. As a Tenet hospital CEO in



the San Gabriel Valley, Mark led strategic oversight for linking the regional community hospitals with Tenet's tertiary system provider, USC University Hospital. Mark also served as CEO of Arrowhead Regional Medical Center, a 543-bed tertiary hospital, and the second largest trauma center in the State of California. As CEO of Arrowhead Regional Medical Center, Mark had responsibility for oversight of the physician residency program and the 501(c)(3) charitable foundation.

Aeoro is committed to maintaining the faith-based and cultural identity of the DCHS hospitals, without exception. Consistent with this commitment, Aeoro will continue to maintain community services.

With respect to charity care, Aeoro recognizes that the adoption of robust charity care policies is beneficial to the community and to the hospital and is committed to maintaining favorable charity care policies.

b. Payor Mix. Aeoro expects to manage and maintain overall payor mix in a manner that substantially mirrors DCHS historical trends and philosophy – and provide care for all members of the communities in which we work.

c. Noteworthy Details Surrounding Any Acquired Catholic Hospitals and Expectations Regarding Operating the DCHS Hospitals Post-Closing (e.g., ERDs, pastoral care, etc.). Aeoro is committed to providing care for the underserved in our communities. We embrace the social responsibility that is an integral part of delivering healthcare and providing community-based health care. We believe that our services should be provided for the common good and benefit of the communities in which we work. As stewards of community health resources, Aeoro will promote and protect the right of each person to basic health care services.

Aeoro's philosophy is to deliver population health services in a compassionate way. Aeoro will provide patients with access to psychiatric, social, and spiritual services to promote healing across the full spectrum of needs for the communities in which we serve.

d. Expectations Regarding Continuation/Cessation of Operations at the DCHS Facilities Post-Closing/Expectations for New Operations. Aeoro expects to manage and maintain hospital operations and facilities in a manner that mirrors substantially the DCHS philosophy – that is, to provide care for the entire community in which we work. Operational plans for each facility will be created and implemented with the participation and collaboration of DCHS clinical and operational teams. The result will likely be services optimized by community and market, with renewed emphasis and investment for certain clinical services in each market that match the needs of each community. Aeoro has allocated \$300MM of capital over the next 5 years to invest in and support the growth of the DCHS operations, services and facilities.



11. **Exclusivity.** In consideration of the substantial expenditure of time, effort and expense to be undertaken by Aeoro in connection with its due diligence review and negotiation and financing of the Transaction, DCHS will not, nor will they permit any of their respective affiliates or any representatives, officers, directors, employees or other agents of any of the foregoing to, initiate, solicit, negotiate, discuss, enter into any agreement with respect to, or provide any information to any third party with respect to, the potential sale of DCHS (or any of its subsidiaries), or a substantial interest therein or any other transaction that would be inconsistent with the Transaction, whether by sale of assets or stock, merger, recapitalization, reorganization or other transaction for a period of one hundred twenty (120) days from our receipt of a signed copy of this Proposal Letter; provided, however, that this exclusivity period may be renewed for additional, successive terms of thirty (30) days by the mutual agreement of the parties if the parties continue to engage in good faith negotiations regarding Transaction. Consistent therewith, DCHS will immediately suspend any existing activities or discussions with all parties other than Aeoro. Further, DCHS agrees that it will disclose to Aeoro any bona fide offers or written inquiries that it receives regarding any such proposal or offer during this exclusive period.

12. **Confidentiality.** Neither DCHS nor Aeoro shall, without the prior written consent of the other party, disclose to any third party the existence of this Proposal Letter, that either party is interested in pursuing the Transaction, or any terms of this Proposal Letter or its proposed Transaction, except as required by law or to comply with such party's obligations contained in this Proposal Letter. The parties acknowledge that certain confidentiality agreement dated as of February 21, 2014, remains in full force and effect.

13. **Governing Law.** This letter and this offer are governed by the laws of the State of Delaware.

14. **Binding Effect.** Except for the provisions of Sections 11, 12, 13 and this Section 14, each of which shall be deemed to be an agreement and binding upon the parties, it is understood that this Proposal Letter does not constitute or give rise to any legally binding commitment on the part of any party. Instead, it merely sets forth their present intentions with respect to the terms proposed, which terms may or may not become part of a Definitive Agreement, as a basis for future negotiations. It is specifically acknowledged and agreed that either party may terminate discussions concerning the Transaction at any time and for any reason.

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We look forward to moving forward with Daughters of Charity Health System and Houlihan Lokey in this transaction process.

Very truly yours,

A handwritten signature in blue ink that reads "Roy Santarella/sga".

Roy Santarella
Chief Executive Officer
AEORO LLC

Agreed to and accepted by:

DAUGHTERS OF CHARITY HEALTH SYSTEM

By: _____
Name: _____
Title: _____