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7 Debtors In Possession

**THIS MOTION IS RE-FILED UNDER THE
CORRECT EVENT CODE PER THE COURT'S
INSTRUCTIONS AT DOCKET NO. 4083. NO
CHANGES HAVE BEEN MADE TO THE
MOTION THAT APPEARS AS DOCKET NO.
4081.**

8 **UNITED STATES BANKRUPTCY COURT**
9 **CENTRAL DISTRICT OF CALIFORNIA - LOS ANGELES DIVISION**

9 In re

Lead Case No. 18-20151-ER

10 VERITY HEALTH SYSTEM OF
CALIFORNIA, INC., *et al.*,

Jointly Administered With:

11 Debtors and Debtors In
12 Possession.

- CASE NO.: 2:18-bk-20162-ER
- CASE NO.: 2:18-bk-20163-ER
- CASE NO.: 2:18-bk-20164-ER
- CASE NO.: 2:18-bk-20165-ER
- CASE NO.: 2:18-bk-20167-ER
- CASE NO.: 2:18-bk-20168-ER
- CASE NO.: 2:18-bk-20169-ER
- CASE NO.: 2:18-bk-20171-ER
- CASE NO.: 2:18-bk-20172-ER
- CASE NO.: 2:18-bk-20173-ER
- CASE NO.: 2:18-bk-20175-ER
- CASE NO.: 2:18-bk-20176-ER
- CASE NO.: 2:18-bk-20178-ER
- CASE NO.: 2:18-bk-20179-ER
- CASE NO.: 2:18-bk-20180-ER
- CASE NO.: 2:18-bk-20181-ER

13 Affects All Debtors

Chapter 11 Cases

- 14 Affects Verity Health System of
California, Inc.
- 15 Affects O'Connor Hospital
- 16 Affects Saint Louise Regional Hospital
- 17 Affects St. Francis Medical Center
- 18 Affects St. Vincent Medical Center
- 19 Affects Seton Medical Center
- 20 Affects O'Connor Hospital Foundation
- 21 Affects Saint Louise Regional Hospital
Foundation
- 22 Affects St. Francis Medical Center of
Lynwood Foundation
- 23 Affects St. Vincent Foundation
- 24 Affects St. Vincent Dialysis Center, Inc.
- 25 Affects Seton Medical Center Foundation
- 26 Affects Verity Business Services
- 27 Affects Verity Medical Foundation
- 28 Affects Verity Holdings, LLC
- Affects De Paul Ventures, LLC
- Affects De Paul Ventures - San Jose
Dialysis, LLC

Hon. Ernest M. Robles

**DEBTORS' NOTICE OF MOTION AND
MOTION FOR ENTRY OF AN ORDER
AMENDING KEY EMPLOYEE INCENTIVE
PLAN AND KEY EMPLOYEE RETENTION
PLAN; MEMORANDUM OF POINTS AND
AUTHORITIES AND DECLARATION OF
RICHARD G. ADCOCK IN SUPPORT
THEREOF**

25 Debtors and Debtors In
26 Possession.

Hearing:
Date: March 17, 2020
Time: 10:00 a.m.
Location: Courtroom 1568
255 E. Temple St., Los Angeles, CA

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1 **PLEASE TAKE NOTICE** that, at the above referenced date, time and location, Verity
2 Health System of California, Inc., and its affiliated debtors and debtors in possession (collectively,
3 the “Debtors”), will move the Court (the “Motion”) for the entry of an order: (i) amending their
4 previously Court-approved key employee incentive plan (the “KEIP”) [Docket Nos. 893, as
5 modified by 3565] and key employee retention plan (the “KERP”) [Docket No. 893] (the
6 “Amendments”), developed to incentivize, reward and retain certain key employees (the “Key
7 Employees”) that remain with the Debtors following (a) the termination of the proposed sale to
8 Strategic Global Management, Inc., and (b) the Debtors’ implementation of alternative transactions
9 to sell their remaining assets; and (ii) granting related relief. True and correct copies of the KEIP
10 and KERP with proposed Amendments are attached to the accompanying Memorandum of Points
11 and Authorities (the “Memorandum”) as **Exhibits “A”** and **“B,”** respectively.

12 **PLEASE TAKE FURTHER NOTICE** that the Motion is based on this Notice, the
13 Motion, the Memorandum, the *Declaration of Richard G. Adcock in Support of Debtors’*
14 *Emergency First-Day Motions* [Docket No. 8], the Declaration of Richard G. Adcock filed
15 concurrently herewith (the “Adcock Declaration”), the *Motion for Entry of an Order Authorizing*
16 *and Approving (I) Key Employee Incentive Plan and (II) Key Employee Retention Plan* (the
17 “KEIP/KERP Motion”) filed with the *Declaration Of Christopher J. Kearns In Support Of Debtors’*
18 *Motion For Entry Of Order Authorizing And Approving (I) Key Employee Incentive Plan And (II)*
19 *Key Employee Retention Plan; And Debtors’ Motion For Entry Of An Order Sealing Employee*
20 *Information* [collectively, Docket No. 631], the *Order Granting Debtors’ Motion for Entry of an*
21 *Order Sealing Employee Information and Denying Evidentiary Objections Thereto* [Docket No.
22 735], the ruling explaining the basis for the granting of the KEIP/KERP Motion [Docket No. 814]
23 (attached as **Exhibit “C”**), the *Order Granting Debtors’ Motion for Entry of an Order Authorizing*
24 *and Approving (I) Key Employee Incentive Plan and (II) Key Employee Retention Plan* [Docket
25 No. 893], the *Motion For Entry Of An Order Amending Key Employee Incentive Plan* [Docket No.
26 3240] (the “First Amendment Motion”), the ruling explaining the basis for granting the First
27 Amendment Motion [Docket No. 3550] (attached as **Exhibit “D”**), and the *Order Granting*
28 *Debtors’ Motion For Entry Of An Order Authorizing And Approving (I) Key Employee Incentive*

1 *Plan And (II) Key Employee Retention Plan* [Docket No. 3565], the entire record of these cases,
2 the statements, arguments and representations of counsel to be made at the hearing on the Motion,
3 if any, and any other evidence properly presented to the Court.

4 **PLEASE TAKE FURTHER NOTICE** that, pursuant to Local Bankruptcy Rule 9013-
5 1(f), any party opposing or supporting to the Motion must file a response (a “Response”) with the
6 Bankruptcy Court and serve a copy of it upon the moving party and the United States Trustee not
7 later than 14 days before the date designated for the hearing. A Response must be a complete
8 written statement of all reasons in opposition to or in support of the Motion, declarations and copies
9 of all evidence on which the responding party intends to rely, and any responding memorandum of
10 points and authorities.

11 **PLEASE TAKE FURTHER NOTICE** that, pursuant to Local Bankruptcy Rule 9013-
12 1(h), failure to file and serve a timely objection may be deemed by the Court to be consent to the
13 relief requested herein.

14
15 DATED: February 12, 2020

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TANIA M. MOYRON
SAM J. ALBERTS

16
17
18 By /s/ Tania M. Moyron
19 TANIA M. MOYRON
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1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 Verity Health System of California, Inc., a California nonprofit benefit corporation and the
3 Debtor herein (“VHS”), and the above-referenced affiliated debtors, the debtors and debtors in
4 possession (collectively, the “Debtors”) in the above-captioned chapter 11 bankruptcy cases (the
5 “Cases”), hereby move (the “Motion”) the Court, pursuant to §§ 107(b), 363(b), 503(b) and 503(c),¹
6 for the entry of an order: (i) amending (the “Amendments”) their existing key employee incentive
7 plan (the “KEIP”) (true and correct copy of KEIP with Amendments attached as **Exhibit “A”**) and
8 key employee retention plan (the “KERP”) (true and correct copy of KERP with Amendments
9 attached as **Exhibit “B”**), to incentivize, reward and retain certain key employees (the “Key
10 Employees”) that remain with the Debtors during or otherwise through culmination of the Debtors’
11 Plan B (defined *infra*), in light of the delay and uncertainty Strategic Global Management, Inc.
12 (“SGM”) caused by failing to close its agreement to purchase the Debtors’ remaining hospitals (the
13 “SGM Sale”); and (ii) granting related relief.

14 **I.**

15 **INTRODUCTION**

16 When the Debtors crafted the KEIP and KERP (collectively, the “Bonus Programs”) soon
17 after the August 31, 2018 “Petition Date,” they could not anticipate the significant delays that would
18 be caused by the protracted California Attorney General (the “AG”) review of the SGM Sale or,
19 subsequently, by SGM’s announced 11th-hour “buyer’s remorse” and refusal to close the \$610
20 million purchase of the Debtors’ remaining hospitals by the December 5, 2019 closing deadline.
21 As such, the original Bonus Programs, which were designed to retain and incentivize Key
22 Employees to maximize value and performance through mid-2019, and were first modified in part
23 to address the delay caused by AG review, now require further adjustments. In fact, with the SGM
24 Sale a nullity and the Cases already more than 17 months old, Key Employees are being called upon
25 to lift flagging morale and redouble efforts in order to preserve and maximize value to creditors, all
26 while maintaining critical, functioning hospital operations.

27 _____
28 ¹ Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532,
and all “Rule” references are to the Federal Rules of Bankruptcy Procedure. All references to “LBR” are to the Local
Bankruptcy Rules of the United States Bankruptcy Court for the Central District of California.

1 Due to these complexities, a mere extension of deadlines is not sufficient here. Rather, the
2 Amendments must actually retool the “square peg” of the KEIP and KERP designed in 2018 for
3 the “round hole” of the changed circumstances now existing in 2020. The proposed changes
4 include:

- 5 • under the KERP (the program for critical non-insiders), a new pool of \$756,000² is
6 available to eligible employees (“KERP Participants”), divided in two parts, a)
7 \$406,000 for standard bonus payments payable to seven (7) specific persons
8 employed at VHS and Verity Business Systems (“VBS”), and b) \$350,000 for
9 discretionary payments for other persons not yet-identified and who may include
10 non-insiders anywhere in the system. The standard pool allows for bonuses that
11 total up to 30% of each listed KERP Participants’ salary, which is in turn divided
12 in two installments, i) 1/10 of the 30% bonus payable within ten (10) business days
13 of entry of the order approving the Amendments and ii) the 9/10 balance payable
14 upon the KERP Participant’s termination. The discretionary pool similarly permits
15 up to 30% of salary of yet-identified persons. The structure is akin to the original
16 proposal, albeit with the expansion of the number of participants;
- 17 • under the KEIP, “Entity KEIP Participants” (those designated insiders employed on
18 the hospital facility level) may receive, under the applicable “Entity KEIP”
19 program, two payments: a) a relatively small bonus equal to 2.5% of the
20 Participant’s salary if the Debtors meet budget under the existing cash collateral
21 order [Docket No. 3883] and b) a separate (larger) bonus equal to 22.5% of the
22 Participant’s salary payable upon disposition of the facility that employs that
23 person.³ This is similar to the original structure, which paid a bonus for the Debtors
24

26 _____
27 ² The net amount of which is actually \$363,000 more than the original KERP program and this increase is offset by
28 reductions under the VHS KEIP.

³ Similar to the original structure, payments to KEIP Participants (both Entity and below-described VHS) are also
available in the event of termination without cause or, in the event of death or disability under a *pro rata* formula.

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1 remaining in compliance under the Debtor-in-Possession financing budget and
2 provided a larger bonus upon the sale of their hospital employer;⁴
3 • under the KEIP, “VHS KEIP Participants” who oversee all of the Debtors, remain
4 necessary for the disposition of the remaining hospital assets and to bring about a
5 conclusion of these Cases and who have received no bonuses to date under the
6 original or first amended “VHS KEIP,” will be entitled to bonuses in two parts: a)
7 payment equal to 10% of that VHS KEIP Participant’s salary (20% for Upper-Level
8 Participants) upon approval of the sale of St. Francis Medical Center (“SFMC”), and
9 b) up to a maximum equal to 50% of salary (or 100%, for the Upper-Level
10 Participants) with respect to the collective value of all hospital and Foundation asset
11 dispositions. It should be noted that the maximum bonus is payable only if the total
12 sale proceeds equal or exceed \$800 million and there will be no second (*i.e.*, “b”)
13 bonus unless incremental sale proceeds are \$310 million above the \$290 million
14 already achieved in the Cases.

15 Notably, the maximum amount of bonuses payable under the Amendments total \$725,000
16 *less than* what was provided under the original Bonus Programs. Also, the additional bonuses
17 provided under the KERP Amendments is more than offset by a reduction of more than \$1 million
18 in KEIP bonuses (as compared to the original KEIP programs).⁵ Similar to the structure of the

19 _____
20 ⁴ Under the original structure, bonuses were paid for meeting the DIP budget and to those participants who remained
21 employed by and through the disposition of Saint Louise Regional Hospital (“SLRH”) and O’Connor Hospital (“OCH”)
to Santa Clara County, and those employed by the VMF which was separately sold. Because of their prior disposition,
the are no Entity Participants remaining at SLRH, OCH or the VMF who are covered under the Amendments.

22 ⁵ A chart demonstrating the aggregated differences between amounts under the original Bonus Programs versus what
23 is being proposed under the Amendments attached as **Exhibit “F.”** A separate chart demonstrating VHS KEIP
24 payments for Sale Proceeds at \$600 million and above is being filed under seal as **Exhibit “G.”** In addition to Exhibit
25 “G,” the amended KEIP attaches two schedules and the amended KERP attaches one schedule, with the names, titles
26 and amounts by individual of the Amendment Employees covered by that Bonus Program (the “Amendment
27 Schedules”). Previously, similar schedules were filed under seal pursuant to the *Order Granting Debtors’ Motion for*
28 *Entry of an Order Sealing Employee Information and Denying Evidentiary Objections Thereto* [Docket No. 735], and,
as such, the Amendment Schedules here are being filed under seal too. As was the previous course of conduct, however,
at the time of the filing of this Motion, the Debtors have or will provide the Amendment Schedules to certain parties
who have executed nondisclosure agreements or otherwise have agreed to treat such information as confidential, which
include: (i) the Unsecured Creditors Committee, (ii) pre-petition lenders, UMB Bank N.A., as Successor Master Trustee
for the Master Indenture Obligations, Wells Fargo Bank National Association as Indentures Trustee for Series 2005
Revenue Bonds, U.S. Bank National Association, as Series 2015 and Series 2017 Note Collateral Agent and Note
Trustee, Verity MOB Financing LLC, and Verity MOB Financing II LLC, (iii) McKesson Corporation, and (iv) the
United States Trustee.

1 original Bonus Programs (including first amended KEIP), a Key Employee cannot receive a
2 payment under both the KERP and KEIP.

3 In total, the Amendments are well-developed, necessary and in the best interest of the
4 estates. Without properly incentivized Key Employees, the Debtors “Plan B” efforts to maximize
5 recoveries and to achieve an efficient exit in these Cases have little prospect for success. Without
6 approval of the Motion, the potential for lost morale and greater attrition (already pronounced and
7 growing throughout the Debtors’ organizations) increases and, with it, near-certain lost value to the
8 estates.

9 Further, the Amendments are warranted to address SGM’s failure to close the SGM Sale.
10 Had that sale closed, the Cases would be closer to being completed and all requisite bonuses paid.
11 This change in circumstance further supports the Amendments. As this Court recognized in the
12 context of approving the amendments to the KEIP caused by the AG-delays, “[a]mendment of a
13 KEIP [or KERP] is appropriate where the amendment is sought as a result of circumstances beyond
14 the control of the key employees” and “were not anticipated at the time the [program was]
15 designed.” Docket No. 3550 at 3. Here, the Key Employees are needed to address problems that
16 are not of their own making yet will require them to expend significant energy and effort to solve.
17 For these and other reasons, the Court should approve the Amendments.

18 **II.**

19 **JURISDICTION, VENUE AND BASIS FOR RELIEF**

20 The Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b). Venue is proper
21 pursuant to 28 U.S.C. §§ 1408 and 1409. This matter is a core proceeding within the meaning of
22 28 U.S.C. § 157(b)(2). The statutory predicates for the relief requested herein are §§ 107(b), 363(b),
23 503(b), and 503(c).

24 **III.**

25 **STATEMENT OF FACTS**

26 **A. General Background**

27 1. On the Petition Date, the Debtors each filed a voluntary petition for relief under
28 chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”). Since the commencement

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1 of their Cases, the Debtors have been operating their businesses as debtors in possession pursuant
2 to §§ 1107 and 1108.

3 2. Additional background facts on the Debtors, including an overview of the Debtors'
4 business, information on the Debtors' debt structure and information on the events leading up to
5 the chapter 11 cases, are contained in the *Declaration of Richard G. Adcock in support of Debtors'*
6 *First-Day Motions* [Docket No. 8].

7 **B. Facts Relevant to Motion**

8 (a) *The KEIP and KERP*

9 3. On October 23, 2018, the Debtors filed their *Motion for Entry of Order Authorizing*
10 *and Approving (I) Key Employee Incentive Plan, and (II) Key Employee Retention Plan* [Docket
11 No. 631] (the "KEIP/KERP Motion") seeking approval of the original version of the KEIP and
12 KERP. On November 13, 2018, the Court issued a ruling [Docket No. 814] (the "KEIP/KERP
13 Ruling," attached as **Exhibit "C"**) approving the KEIP and KERP. The Court found that the
14 Debtors had met the "business judgment" standard of § 363(b) and the requirements of § 503(b) for
15 payments to employees outside of the ordinary course of business, as well as the factors articulated
16 in *In re Dana Corp.*, 358 B.R. 567, 576–77 (Bankr. S.D.N.Y. 2006) (the "Dana Factors").
17 KEIP/KERP Ruling page 4 of 6 (located on top of the document). On November 28, 2018, the
18 Court entered an order consistent with the KEIP/KERP Ruling approving the KEIP and KERP (the
19 "KEIP/KERP Order") [Docket No. 893].

20 4. Approximately one year later on October 4, 2019, the Debtors filed their *Motion For*
21 *Entry Of An Order Amending Key Employee Incentive Plan* [Docket No. 3240] (the "First
22 Amendment Motion"), seeking to amend the KEIP to allow seven employees to receive a 15%
23 salary bonus if the SGM Sale closed by December 31, 2019, instead of 3%. The Debtors filed the
24 First Amendment Motion due to unanticipated delays in the closing of the SGM Sale caused by the
25 AG's extended review of that proposed transaction. The First Amendment Motion was unopposed.
26 On November 6, 2019, the Court issued a ruling explaining the basis for granting the First
27 Amendment Motion [Docket No. 3550] (the "Amendment Ruling," attached as **Exhibit "D"**), and
28

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1 granted the Motion on November 8, 2019 [Docket No. 3565] (the “First Amendment Order, and,
2 together with the KEIP/KERP Order, the “KEIP/KERP Orders”).

3 5. The KEIP/KERP Orders authorized three distinct bonus programs, which provided
4 different treatment for three different categories of Key Employees: 1) KERP Participants; 2)
5 Entity KEIP Participants; and 3) VHS KEIP Participants. Moreover, none of the Participants were
6 entitled receive bonuses under more than one Bonus Program. *See* Declaration of Richard G.
7 Adcock (the “Adcock Decl.”) at ¶ 5.

8 6. On December 27, 2018, after the culmination of a marketing process that began
9 almost immediately after the Petition Date, the Court entered an order approving the sale of all
10 assets (excluding cash, accounts receivables and causes of action) of OCH and SLRH [Docket No.
11 1153] (the “SCC Sale”). Due to the significant efforts of the Debtors’ Key Employees, notably the
12 VHS KEIP Participants, who have not yet received any bonus, who made themselves constantly
13 available for diligence and transition issues with the buyer and who helped maintain the going-
14 concern value of those two hospitals pending closing, the SCC Sale closed on February 28, 2019,
15 resulting in \$235 million in proceeds to the Debtors’ estates. *See* Adcock Decl. at ¶ 6.

16 7. The Debtors have also sold approximately \$2.4 million of Verity Medical
17 Foundation’s (“VMF”) assets in Court-approved transactions (the “VMF Transactions”). For
18 example, VMF entered into settlements and asset purchase agreements with Union Square Hearing,
19 Inc. [Docket Nos. 2439, 2693], San Jose Medical Group and Silicon Valley Medical Development,
20 LLC [Docket Nos. 1636, 1919], Oncology Technology Associates, LLC [Docket Nos. 1635, 1915],
21 and All Care Medical Group, Inc. [Docket Nos. 1180, 1368]. The Key Employees, particularly the
22 VHS KEIP Participants, were integral to this effort. *See* Adcock Decl. at ¶ 7.

23 8. Certain Key Employees received KEIP and KERP payments as a result of the SCC
24 Sale and VMF Transactions. Employees under the KEIP (“KEIP Participants”) employed by OCH
25 and SLRH received the maximum bonus tied to the timing of the SCC Sale (15% of salary) in mid-
26 2019. *See* Adcock Decl. at ¶ 8. During the SCC Sale process, the Debtors made retentive KERP
27 Payments, with the final payment (to employees in good-standing) made on or around June 30,
28 2019. *See id.* KERP Participants who were terminated by the Debtors but otherwise employed in

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1 good-standing at the time of the closing of the SCC Sale received severance under the KERP. *See*
2 *id.* The Debtors did not make any payments under the VHS KEIP because, under its terms, no
3 payment was due at that time. *See id.* To date, the Debtors have paid a total of \$1,057,515 under
4 the Entity KEIP and \$887,825 under the KERP. *See id.*

5 (b) ***The SGM Sale and SGM’s Refusal to Close***

6 9. On January 8, 2019, the Debtors and SGM entered into that certain Asset Purchase
7 Agreement [Docket No. 2305-1] (the “SGM APA”) related to SGM’s proposed acquisition of St.
8 Vincent Medical Center (“SVMC”), Seton Medical Center (“SMC”), Seton Coastside, and SFMC.
9 The SGM APA had an outside closing date of December 31, 2019 (the “SGM Closing Date”). *See*
10 SGM APA at §§ 9.1(e) & (f).

11 10. The SGM closing was first delayed and then terminated due to circumstances outside
12 of the control of the Key Employees. ***First***, the AG took the full time to issue a decision regarding
13 the SGM Sale (September 25, 2019) and with it, attempted to impose significant conditions. On
14 September 30, 2019, the Debtors filed a motion challenging the AG’s decision [Docket No. 3188]
15 (the “Enforcement Motion”). In an effort to address those delays, on October 4, 2019, the Debtors
16 filed their First KEIP Amendment Motion because the existing Entity KEIP Participants were slated
17 to receive only a fraction of their possible bonus (despite working significantly longer than fully
18 KEIP-vested OCH/SLRH Key Employees) due to the delays caused by the AG review. The
19 Debtors reached a stipulation with the AG, which the Court granted on November 14, 2019. Docket
20 No. 3611 (the “Enforcement Order”).

21 11. ***Second***, SGM ultimately—and unexpectedly—refused to close the SGM Sale.
22 Notwithstanding the Debtors’ effort to compel SGM to close and the entry of orders of this Court
23 seeking to effect such a result, SGM failed to perform.⁶ On December 9, 2019, the Court entered
24 an order [Docket No. 3784] confirming that the Debtors could undertake a “Plan B,” and pursue
25 efforts “with respect to the alternative disposition of the hospitals” without violating or breaching
26

27
28 ⁶ This Court is well aware of the efforts to compel SGM to close the transaction and the orders entered related thereto and, thus, are not separately cited herein.

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1 the SGM APA. Docket No. 3784 at 2. On December 27, 2019, the Debtors terminated the SGM
2 APA. *See* Docket No. 3899.⁷

3 12. Since the termination of the SGM APA, the Debtors have focused their efforts on
4 implementing Plan B. Adcock Decl. at ¶ 9 On January 6, 2020, the Debtors filed an emergency
5 motion to close SVMC [Docket No. 3906]. On January 9, 2020, the Court entered an order
6 authorizing the closure of SVMC [Docket No. 3934].

7 **C. The Proposed Amendments**

8 13. The Amendments propose specific relief to address specific concerns. Adcock Decl.
9 at ¶ 10. True and correct copies of the actual Amendments, along with schedules identifying
10 payments, are attached as **Exhibits “A”** (KEIP) and **“B”** (KERP) hereto (*see* Adcock Decl. at ¶ 10
11 (certifying Amendments are true and correct as attached hereto)), and are summarized here as
12 follows:

- 13 • **KERP Participants** will be entitled to receive from one of two bonus pools totaling
14 \$756,000: a) a pool of \$406,000 for standard bonus payments; and b) a pool of \$350,000
15 for discretionary payments. The pool for standard payments provides up to 30% of each
16 listed KERP Participants’ contractual compensation, payable in two installments, i) 1/10
17 of the 30% bonus payable within ten (10) business days of entry of the order approving
18 the Amendments and ii) the 9/10 balance payable upon the KERP Participant’s
19 termination. The discretionary pool may be used to provide as yet-identified future
20 KERP Participants, up to 30% of their salary. It should be noted that:

- 21 ○ Maximum KERP payments, assuming the Debtors fully utilize the Amended
22 KERP Pool, under the Amendments total \$756,000, which is \$363,000 more
23 than the original KERP program.

24
25
26
27 _____
28 ⁷ On January 3, 2020, the Debtors filed a complaint against SGM and its affiliates related to the termination of the SGM
APA. *See* Docket No. 3901. SGM has moved the District Court to withdraw the reference of that Motion, which the
Debtors have opposed.

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- 1 ○ The amended KERP amounts are in addition to the three installment payments
2 of 6% each (18% total) that were paid up through June 2019.⁸ Therefore, if
3 someone had been a KERP employee under the original KERP and still remains
4 employed through the end of the Cases, they may receive a total equal to 18%
5 for past payments plus 30% for future payments. Adcock Decl. at ¶ 10(a).
- 6 ● **KEIP Participants** will continue to be organized into one of two general groups:
- 7 ○ **Entity Participants**, which is comprised of six (6) employees (originally 16)
8 whose assistance is needed to maintain the hospital operations until the
9 disposition of the facility in which he or she works;
- 10 ○ **VHS Participants**, which includes seven (7) employees (originally nine), all of
11 whose assistance is required to maximize value from the disposition of all of
12 VHS systems material assets (however long that may take); certain of whom
13 continue to constitute Upper-Level VHS Participants. Adcock Decl. at ¶ 10(b).
- 14 ● **KEIP bonuses** payments depend upon the group they are in:
- 15 ○ **Entity Participant bonuses** were comprised of two parts: 1) a performance
16 bonus measured against the budget relating to the Debtor in Possession (DIP)
17 Financing, which occurred and which bonuses have been paid and 2) the
18 disposition of the facility that employ(s)(ed) them. As proposed, the
19 Amendments provide:
- 20 ▪ a bonus equal to 2.5% of each Entity Participant’s respective salary upon
21 compliance with the existing cash collateral budget through February
22 2020;
- 23 ▪ a bonus equal to 22.5% of each Entity Participant’s respective salary
24 upon termination without cause after the disposition of the hospital that
25 employs them Adcock Decl. at ¶ 10(c).

28 ⁸ In addition to those three payments (which equal 18%) KERP employees could receive 12% upon termination. KERP employees who were terminated and received the 12% termination are not among the current KERP Participants.

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- 1 ○ **VHS Participant bonuses** were previously tied exclusively to total recoveries
2 of all VHS system assets. Because of SGM’s refusal to close, not all assets have
3 been disposed and, thus, no bonuses have been paid to any VHS Participants.
4 To remedy,
- 5 ▪ VHS Participants (currently seven (7) in total), may receive a total bonus
6 equal to 50% of his or her annual salary, and the Upper-Level VHS
7 Participants who may receive bonuses equal to 100% of their respective
8 annual salaries, as follows:
 - 9 • 10% of salary value (20% for the Upper-Level VHS Participants)
10 is payable upon entry of an order approving a sale of SFMC;
 - 11 • Up to 40% of salary value (80% for the Upper-Level VHS KEIP
12 Participants) is payable upon disposition of all facilities with
13 bonus measured by the value of such assets sales, with the
14 maximum tied to an aggregate sale proceeds value of at least
15 \$800 million (which measurement includes the SCC Sale and the
16 VMF Transactions). Adcock Decl. at ¶ 10(d).
 - 17 ○ The VHS Participants receive no additional incentive for asset sale proceeds
18 between the \$290 million of proceeds, already achieved through the VMF, OCH
19 and SLRH sales, and \$599 million. Therefore, if the SFMC and SVMC sales do
20 not generate incremental proceeds of at least \$310 million, these participants will
21 have earned no additional incentive. Adcock Decl. at ¶ 10(d).

IV.

ARGUMENT

A. The Key Employees’ Contributions and the Need for the Amendments

25 Throughout these Cases, the Debtors’ Key Employees have worked to the benefit of the
26 Debtors’ estates by overseeing and ensuring the continued efficient and effective operations of the
27 Debtors’ hospitals, thereby providing medical care to thousands of patients and employment to
28 thousands of staff, while also preserving and maximizing value to creditors. Each Key Employee

1 has been critical to these efforts, including by interacting with potential purchasers, maintaining
2 effective operations, providing patient care, and maintaining doctor and employee morale. *See*
3 Adcock Decl. at ¶ 11. Key Employees already have guided the Debtors toward the successful
4 completion of the SCC Sale (\$282.3 million in cash consideration) and VMF Transactions (\$7.6
5 million in consideration). Although certain KEIP Key Employees were rewarded for their efforts
6 in connections with those transactions (and KERP Key Employees for remaining), significant work
7 remains and the Debtors must retain and incentivize Key Employees through 2020. *See id.*

8 In fact, due to SGM's unexpected refusal to close a sale transaction for substantially all of
9 the Debtors' remaining non-cash assets, remaining Key Employees are now being called upon to
10 work harder and longer to effectuate Plan B. *See* Adcock Decl. at ¶ 12. Among other things, Plan
11 B requires Key Employees to maintain patient care and operations at the Debtors' remaining
12 hospitals, oversee the liquidation at SVMC and concurrently coordinate multiple transactions for
13 the Debtors' remaining assets either as going-concern sales or alternative transactions for the benefit
14 of the Debtors' estates. Indeed, certain of the positions filled by Key Employees must remain
15 staffed under California law applicable to operating hospitals. *See id.*

16 The need for the proposed Amendments is further warranted due to the increased risk of
17 attrition. *See* Adcock Decl. at ¶ 13. This concern is well-founded. Even before these Cases, from
18 August 30, 2017 to August 30, 2018, more than 80 employees in leadership and other critical
19 positions left the Debtors, including four CEOs, one Chief Medical Officer, one Nurse Executive,
20 eleven Vice Presidents, three CFOs, and fourteen Clinical Directors/Managers. *See id.* During
21 these Cases, further attrition has occurred as evidenced by several examples, including:

- 22 • VHS' Chief Financial Officer resigned;
- 23 • VHS' Chief Information Officer resigned;
- 24 • SMC lost its Chief Executive Officer, Chief Financial Officer and two successive
25 Chief Nursing Officers in 2019;
- 26 • the Debtors' hospitals have lost KERP-eligible positions of controller, executive
27 director of patient financial services, director of strategy/financial analysis and director of hospital
28 finance; and

1 • in 2019, total turnover was 15% at SMC, 14% at SFMC, and 46% at VHS (which
2 jumped from 27% as of September 2019 to 46% by the end of 2019), further adding to the burden
3 of the Key Employees. *See id.*

4 This attrition has been paired with the Debtors' increasing difficulties with recruitment and
5 hiring of new talent, given that the Debtors are now undertaking Plan B. *See Adcock Decl.* at ¶ 14.

6 Going forward, the Debtors face even more risks. Many Key Employees expected to
7 continue working in similar positions for SGM after the closing of the SGM Sale and, therefore had
8 an incentive to remain in the Debtors' employment through the then-expected December 2019
9 closing. *See Adcock Decl.* at ¶ 15. Since the SGM Sale did not occur, such incentive no longer
10 exists. In fact, the proposed Amendments are meant to address, in part, the loss of that incentive
11 caused by the loss of the SGM Sale and the uncertainties presented by Plan B. The Debtors also
12 will be asking each participant to take on greater responsibilities and therefore, an increased amount
13 of required work hours, in order to maximize value to the estates. *See id.*

14 **B. The Amendments Meet the Business Judgment Test**

15 Section 503(c)(3) requires that payments to a debtor's employees outside of the ordinary
16 course of business be "justified by the facts and circumstances of the case" to be allowed under
17 § 503(b)(2). This standard is no different from the business judgment standard under § 363(b). *See*
18 *KEIP/KERP Ruling* [Docket No. 814] page 5 of 6 (located on top of the document) (collecting
19 cases). Courts presume that a KEIP "established post-petition by a debtor-in-possession for the
20 benefit of senior management is in the ordinary course of the Debtors' business." *In re Nellson*
21 *Nutraceutical, Inc.*, 369 B.R. 787, 798 (Bankr. D. Del. 2007) (cited by *KEIP/KERP Ruling* page 5
22 of 6 (located on top of the document)). Further, a KERP is proper if "a sound business purpose
23 exists for the plan and [if] the plan itself is fair and reasonable." *In re Walter Energy, Inc.*, 2015
24 WL 9583521, at *4 (Bankr. N.D. Ala. Dec. 28, 2015) (quoting *In re Allied Holdings, Inc.*, 337 B.R.
25 716 (Bankr. N.D. Ga. 2005) (quoting *In re Georgetown Steel*, 306 B.R. 549, 556 (Bankr. D.S.C.
26 2004)).

27 Additionally, the Court may authorize the Debtors to implement the Amendments under §
28 363(b)(1), which provides that "[t]he trustee, after notice and a hearing, may use, sell, or lease,

1 other than in the ordinary course of business, property of the estate.” 11 U.S.C. § 363(b)(1). The
2 use, sale or lease of property of the estate, other than in the ordinary course of business, is authorized
3 when a “sound business purpose” justifies such action. *See, e.g., In re Pomona Valley Med. Group,*
4 *Inc.*, 476 F.3d 665, 670 (9th Cir. 2007).

5 The Ninth Circuit applies the business judgment rule for debtors in possession because
6 “courts are no more equipped to make subjective business decisions for insolvent businesses than
7 they are for solvent businesses.” *Id.* “In evaluating the [business] decision, the bankruptcy court
8 should presume that the debtor-in-possession acted prudently, on an informed basis, in good faith,
9 and in the honest belief that the action taken was in the best interests of the bankruptcy estate.” *Id.*
10 The Court should only override the Debtors’ business decision if the evidence shows it “is so
11 manifestly unreasonable that it could not be based on sound business judgment, but only on bad
12 faith, or whim or caprice.” *Id.*

13 The Debtors have determined, utilizing their reasonable business judgment, that the
14 Amendments are necessary to manage the orderly disposition of the remaining hospitals and assets
15 and otherwise maximize Plan B’s value. Adcock Decl. at ¶ 16. Therefore, the Amendments are in
16 the best interest of the Debtors’ creditors and estates and should be approved pursuant to
17 §§ 503(b)(2), 503(c)(3), and 363(b).

18 **C. Amendment of the KERP and KEIP Is Appropriate Under the Circumstances**
19 **and the Evidence Provided.**

20 As the Court identified in its Amendment Ruling, it is appropriate to amend a bonus program
21 when circumstances beyond the key employees’ control render the current program unjust or ill-
22 suited to its purpose. *See* Am. Ruling page 3 of 7 (located on top of the document). Specifically,
23 amendment is appropriate when the changed circumstances are not the key employee’s fault “and
24 were not anticipated at the time the Debtors designed the [KEIP and KERP].” *See Order*
25 *Authorizing LightSquared to Modify and Extend Existing Key Employee Incentive Plan*, Case No.
26 12-12080, Docket No. 2274 at *1 (Bankr. S.D.N.Y. Mar. 27, 2015). In *In re Lightsquared, Inc.* the
27 debtors obtained approval of a key employee incentive plan (the “*Lightsquared KEIP*”), and then
28 experienced a “delayed timeline dictated by various unforeseen complexities and circumstances

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1 that [arose] in the Chapter 11 Cases,” notably regulatory delays from the Federal Communications
2 Commission. *See id.*, Docket No. 2181, at **3-7 (Bankr. S.D.N.Y. Mar. 5, 2015). The debtors
3 requested that the Bankruptcy Court for the Southern District of New York modify the original key
4 employee incentive program to correspond with the delayed timeline. *See id.* The debtors argued
5 that they needed the amendment to “continue to actively manage [their] operations and ongoing
6 business relationships in a fiscally prudent manner [to reach] the effective date of the Plan.” *Id.* at
7 *6. The Court granted the amendment and “authoriz[ed] LightSquared to modify and extend
8 LightSquared’s existing Key Employee Incentive Plan to accommodate the current facts and
9 circumstances of the Chapter 11 Cases.” *See Order Authorizing LightSquared to Modify and*
10 *Extend Existing Key Employee Incentive Plan*, Case No. 12-12080, Docket No. 2274 at *1 (Bankr.
11 S.D.N.Y. Mar. 27, 2015) (the “Lightsquared Order”).⁹

12 Here, the facts and circumstances of the Cases brought about by the failure of SGM to close
13 the SGM Sale were unforeseen when the Bonus Programs were originally implemented, and
14 remained unforeseen upon the first KEIP amendment. Specifically, the retentive and incentivizing
15 objectives of the current KERP and KEIP were implemented with the expectation that the Debtors’
16 going-concern sales would close in 2019. Adcock Decl. at ¶ 17. By contrast, Plan B is an
17 alternative strategy implemented as a result of SGM’s refusal to close the SGM Sale and the
18 December 27, 2019 termination of the SGM APA. *See id.* As such, without the Amendments, the
19 current structures of the KERP and KEIP are not designed to incentivize or retain the Key
20 Employees during the implementation of Plan B. *See id.*

21 The Debtors’ proposed Amendments are further supported by the Declarations of Richard
22 G. Adcock, as well as the analysis, research and information, including of market comparable and
23 structuring, set forth in the *Declaration Of Christopher J. Kearns In Support Of Debtors’ Motion*
24 *For Entry Of Order Authorizing And Approving (I) Key Employee Incentive Plan And (II) Key*
25 *Employee Retention Plan; And Debtors’ Motion For Entry Of An Order Sealing Employee*
26 *Information* (the “Kearns Declaration”) [Docket No. 631] appended to the KEIP/KERP Motion.
27 The Debtors and their advisors, Berkeley Research Group, LLC (“BRG”) have developed the

28 ⁹ These documents are attached to the First Amendment Motion.

1 Amendments by considering the analysis set forth in the Kearns Declaration to the changed
2 circumstances of the Cases, the increased workload (by sheer hours and by the demanding nature
3 of the work especially considering the unforeseen loss – and general inability to find replacements
4 – of key personnel to date) now required by the Key Employees for a successful Plan B, and the
5 increased threat to Key Employee morale presented by Plan B. *See* Adcock Decl. at ¶ 18.

6 **D. The Amendments Meet the *Dana* Factors**

7 The Amendments are appropriately calculated to incentivize and otherwise retain the Key
8 Employees during implementation of Plan B, pursuant to the “*Dana* Factors” which are: (i) whether
9 the plan is calculated to achieve the desired performance; (ii) whether the cost of the plan is
10 reasonable in the context of the debtor’s assets, liabilities and earning potential; (iii) whether the
11 scope of the plan is fair and reasonable; (iv) the due diligence efforts of the debtor in investigating
12 the need for a plan and which key employees need to be incentivized; and (v) whether the debtor
13 received independent counsel in performing due diligence in creating and authorizing the incentive
14 compensation. *See* KEIP/KERP Motion at 16-23 (analyzing *Dana Corp.*, 358 B.R. at 576–77).

15 **i. *The Bonus Programs are Calculated to Achieve the Debtors’ Goals,***
16 ***which are Reasonable under the Context of the Case***

17 The KEIP awards employees after their performance aids the Debtors in achieving specific,
18 pivotal goals of selling hospitals and meeting budget requirements. The majority of the recovery
19 for VHS KEIP Participants is triggered upon the “Sale Proceeds” (as defined in the KEIP), a metric
20 under which the bonus may increase or decrease based on the level of total Sale Proceeds realized.
21 The VHS KEIP payment tied to the approval of a sale of SFMC and also incentivizes the
22 participants to perform. Although Sale Proceeds include a credit of \$290 million with respect to
23 the VMF Transactions and SCC Sale, it raises the minimum requisite sale value trigger from \$300
24 million under the original KEIP to \$600 million. *See* **Exhibit “G”** (chart demonstrating VHS KEIP
25 bonuses if Sale Proceeds at or above \$600 million).¹⁰ This change actually increases the burden on
26 VHS KEIP Participants who must now achieve values of an additional \$310 million to begin to
27 receive bonuses under the total value formula.

28

¹⁰ This Exhibit is being filed under seal.

1 The Entity KEIP incentivizes its Participants to keep the hospitals within the Debtors cash
2 collateral budget and also to sell or wind-down the facility that employs them.¹¹ The Amendments
3 retain the spirit of the previously approved Entity KEIP, but modify it to reward Key Employees to
4 work to sell or wind-down assets in a beneficial manner and reflects the changed circumstances of
5 these cases.

6 On the whole, the Amendments to the KEIP, which are tied to the successful disposition of
7 assets and, also budget-meeting metrics for Entity KEIP Participants, comport with precedent. *See*
8 *In re Velo Holdings Inc.*, 472 B.R. 201, 211 (Bankr. S.D.N.Y.) (approving payment of 1% of sale
9 proceeds to single executive under KEIP); *see also In re Am. Eagle Energy Corp.*, 2016 WL
10 3573952, at *4 (Bankr. D. Colo. June 23, 2016) (approving KEIP) (“the Court concludes that the
11 driving factor incentivizing [the participants] to stay and perform [through the KEIP] was to
12 complete a sale of the oil producing assets that would maximize their value to the estate”); *In re*
13 *Alpha Nat. Res., Inc.*, 546 B.R. 348, 359–60 (Bankr. E.D. Va. 2016), *aff’d sub nom. United Mine*
14 *Workers of Am. 1974 Pension Plan & Tr. v. Alpha Nat. Res., Inc.*, 553 B.R. 556 (E.D. Va. 2016)
15 (“Notably, the [participants] can earn a ‘target’ level payout for confirmation of a Chapter 11 plan
16 or a [timely] sale of substantially all of the Debtors’ assets.”); *In re Borders Group, Inc.*, 453 B.R.
17 459, 473 (Bankr. S.D.N.Y. 2011) (“As further evidence that the KEIP is primarily incentivizing,
18 the size of the KEIP award is dependent on how quickly the Debtors emerge from bankruptcy”).
19 Even assuming the program also contains a retentive element, this would not change the propriety
20 of the Amendments. As one of just several courts have noted, “[t]he fact that . . . all compensation
21 has a retention element [should] not reduce the Court’s conviction” that the debtors’ primary goal
22 in approving the incentive plans was “to create value by motivating performance”). *In re Global*
23 *Home Prods. LLC*, 369 B.R. 778, 786 (Bankr. D. Del. 2007); *see also In re Dana Corp.*, 358 B.R.
24 at 571 (“because a plan has some retentive effect does not mean that the plan, overall, is retentive
25 rather than incentivizing in nature.”).

26 The KEIP’s metrics, which tie bonuses to performance to motivate the closing, transfer or
27 liquidation of health-care facilities, are also directly in accord with §§ 363(b) and 503(c) precedent.

1 *In re Victor Valley Community Hospital*, Case No. 12-12896-CB (Bankr. C.D. Cal.) (*Order*
2 *Granting Motion of Debtor for Order Approving A Key Employee Incentive Plan and Authorizing*
3 *Payments Thereunder* [Victor Docket No. 608] (attached as **Exhibit “E-1”**) (approving, under §§
4 363(b) and 503(c), incentive program remaining employees at hospitals who would play an integral
5 role in providing a smooth transition of the hospital operated by the debtor to the buyers of the
6 hospital) (motion seeking relief attached as **Exhibit “E-2”**) (“the nature of the [key employees]
7 duties will change as they will be asked to take on the responsibilities associated with winding down
8 the estate ...”); *In re Albert Lindley Lee Memorial Hospital*, Case No. 09-30845 (Bankr. N.D.N.Y.)
9 (*Order Approving Key Employee Incentive Plan*, Jun. 8, 2009) [Albert Docket No. 192] (attached
10 as **Exhibit “E-3”**) (approving incentive program for seven remaining employees, from an original
11 319, who remained at health-care facility which was closing with payments tied to winding down
12 of facilities) (motion seeking relief attached as **Exhibit “E-4”**).

13 The amended KERP is also appropriately targeted and in accord with precedent. *See*
14 KEIP/KERP Order (approving structure of KERP still reflected in Amendments). The KERP
15 standard bonus pool of \$406,000 permits a small bonus equal to 1/10 of 30% of salary within ten
16 (10) after entry of the order approving the Amendments, with the balance due upon termination,
17 which fall within existing precedent. *See In re Tribune Co.*, Case No. 08-13141, Docket Nos. 324,
18 340 (Bankr. D. Del.) (approving bonuses ranging from 7-50% of total compensation to be paid
19 annual, quarterly or monthly); *In re Vartec*, Case No. 04-81694, Docket No. 810 (Bankr. N.D. Tex.)
20 (5-10% salary bonus paid on petition date). This formula is fair because it is in exchange for
21 increased demands of increased work-load. Further, the discretionary bonus pool of \$350,000 for
22 other yet-identified employees is a proper approach as it allows the Debtors flexibility in adapting
23 to Plan B’s elastic demands without having to expend time and resources by filing another
24 motion(s).¹²

25
26 ¹² *See In re Tribune Co.*, Case No. 08-13141, Docket Nos. 324, 340 (Bankr. D. Del.) (approving discretionary bonuses
27 granted ranging from \$1,000 to \$10,000 on annual basis, with amounts determined by departments); *In re Bombay Co.*
28 *Inc.*, Case No. 07-44084, Docket Nos. 537, 603 (Bankr. N.D. Tex.) (approving severance pool); *In re Vartec*, Case No.
04-81694, Case No. 810 (Bankr. N.D. Tex.); *In re Allied Holdings, Inc.*, 337 B.R. 716, 718 (Bankr. N.D. Ga. 2005)
(approving pool of \$150,000 for discretionary bonuses not to exceed an individual amount of \$30,000 for other
employees).

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1 In addition, the need to promptly combat negative morale caused by the drastic changes
2 during the Debtors' Cases—and the Debtors' need for Key Employees to remain and implement
3 Plan B well into 2020—cannot be overstated. VHS KEIP Participants have shepherded the Debtors
4 through the closings of the SCC Sale and VMF Transactions, but have not received any bonuses.
5 Such Key Employees worked tirelessly to satisfy all conditions to closing the SGM Sale. Adcock
6 Decl. at ¶ 19. But for SGM's failure to close, Key Employees would have received well-deserved
7 bonuses in late 2019 or early 2020. Indeed, many Key Employees relied on the prospect of future
8 employment in a similar capacity upon the closing the SGM Sale—a possibility that is no longer
9 available following the failure of the SGM Sale. *See id.* Absent approval of the Amendments, the
10 threat of attrition among Key Employees will greatly and quickly increase as the Cases continue
11 and, it will be difficult, perhaps impossible, to replace these persons under the circumstances. *See*
12 *id.*; *see also In re Glob. Aviation Holdings Inc.*, 478 B.R. 142, 151 (Bankr. E.D.N.Y. 2012) (“no
13 showing of a bona fide job offer or any other evidence of an intent to leave is required to pay a
14 bonus [under a KERP]” and finding KERP reasonable under business judgment where Debtors
15 concluded that “at least one” KERP employee would, without the KERP, leave); *In re Borders*
16 *Group, Inc.*, 453 B.R. at 474 (approving KERP) (“[G]iven the circumstances of these cases, it would
17 be very difficult for the Debtors to recruit and train individuals [to replace the KERP employees]
18 in a timely manner with a minimal disruption of business operations.”).

19 Accordingly, the Debtors submit that the Amendments are calculated to retain and
20 incentivize Key Employees to implement and effectuate the transactions contemplated by Plan B.

21 ***ii. The Cost and Scope of the Programs are Fair and Reasonable***

22 If maximum bonuses are paid (meaning the Debtors' key employees remain eligible and
23 help bring in Sale Proceeds equal to or exceeding \$800,000,000 in these Cases), the Amendments
24 in total represent an overall decline of \$725,000 from the existing Bonus Programs. Adcock Decl.
25 at ¶ 20. The proposed decrease is reflective of the attrition experienced with the participants (which
26 have not been replaced) under the Bonus Programs. *See id.* Although total KERP payments may
27 increase by \$363,000, and bonuses for KEIP Entity Participants increase modestly by \$21,000,
28 those increases are more than offset by the \$1.1 million reduction in proposed payments to VHS

1 KEIP Participants from the original KEIP. *See id.*; **Exhibit “F.”** Moreover, the current proposed
2 payments are appropriate in consideration of multiple months of extra labor under stressful
3 conditions now required, greatly exceeding the demands contemplated under the current Bonus
4 Programs.¹³ Adcock Decl. at ¶ 20. The Key Employees must perform the demanding job of
5 operating hospitals and healthcare businesses, all while conducting sales and alternative
6 transactions for each the hospitals. *See id.*

7 Further, while all of the Debtors’ employees play a role in the Debtors’ overall financial
8 success, the Debtors have limited the Amendments to employees (a tiny fraction of the Debtors’
9 current, total workforce) who manage the remaining hospitals and businesses and who are critical
10 to (a) the Debtors’ ability to operate, sell, and if necessary, wind-down, the hospitals during Plan
11 B, (b) preserving the value of the Debtors’ remaining assets, and (c) delivering high quality patient
12 care. *See* Adcock Decl. at ¶ 21; KEIP/KERP Orders. The Key Employees have already
13 demonstrated their commitment and ability to maintain operations and maximize value through the
14 SCC Sale, the VMF Transactions and the satisfaction of the Debtors’ conditions to close the SGM
15 Sale. Retaining (under the KERP) and incentivizing (under the KEIP) Key Employees further
16 benefits the Debtors’ estates to the extent the Debtors avoid the negative financial consequences of
17 an unsuccessfully executed Plan B. As such, the structure of the proposed Amendments is
18 reasonable.

19 ***iii. The Programs Comport with Industry Standards and Were Designed***
20 ***Through Independent, Thorough Due Diligence***

21 The Debtors have performed all necessary due diligence and obtained informed,
22 independent advice from their professionals with respect to the Amendment. *See* Adcock Decl. at
23 ¶ 18. The Amendments adopt the analysis undertaken in the Kearns Declaration, and incorporate
24 the underlying data and findings to the changed circumstances of Plan B. *See id.* The Amendments
25 were designed with BRG, whose principals work closely with the Debtors in the management and
26

27 ¹³ *In re Allied Holdings, Inc.*, 337 B.R. 716, 718 (Bankr. N.D. Ga. 2005) (approval of bonus up to 150% of base salary);
28 *In re Alpha Nat. Res., Inc.*, 546 B.R. at 362 (Bankr. E.D. Va.) (KEIP of 60-175% of salary approved tied to sale proceeds,
et. al.); *In re Velo Holdings Inc.*, 472 B.R. at 211 (approving payment of 1% of sale proceeds to single executive under
KEIP).

1 operations of the Debtors and are well-positioned to assess the Debtors' acute need to retain and
2 incentivize the Key Employees. *See id.* Thus, all *Dana* Factors support the requested relief.

3 V.

4 **CONCLUSION**

5 **WHEREFORE**, the Debtors respectfully request that the Court enter an order (i) granting
6 the Motion, (ii) approving the Amendments, and (iii) granting to the Debtors such other and further
7 relief as the Court may deem just and proper.

8 Dated: February 12, 2020

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9
10
11 By /s/ Tania M. Moyron
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DECLARATION OF RICHARD G. ADCOCK

I, Richard G. Adcock, declare that if called on as a witness, I would and could testify of my own personal knowledge as follows:

1. I make this declaration (the “Declaration”) in support of the *Debtors Motion for Entry of Order Amending Key Employee Incentive Plan and Key Employee Retention Plan* (the “Motion”).¹⁴

2. I am the Chief Executive Officer (“CEO”) of Verity Health System of California, Inc. (“VHS”). I became VHS’ CEO effective January 2018. Prior thereto, I served as VHS’ Chief Operating Officer (“COO”) beginning in August 2017. In my roles as COO and CEO at VHS, I have become intimately familiar with all aspects of VHS and its above-captioned affiliates who have also filed for bankruptcy protection (collectively the “Debtors,” and each a “Debtor”) as well as those affiliated entities that are not in bankruptcy.

3. I have worked for more than 14 years in the healthcare arena. During this period, I have accumulated extensive senior level experience in the areas of not-for-profit healthcare, especially in healthcare delivery, hospital acute care services, health plan management, product management, acquisitions, integrations, population health management, budgeting, disease management and medical devices. I also have meaningful experience in other related areas, including human resources and personnel management.

4. My background and familiarity with the Debtors’ day-to-day operations, business and financial affairs, and the circumstances leading to the commencement of these chapter 11 bankruptcy cases are set forth more fully in my *Declaration filed in Support of Emergency First-Day Motions* [Docket No. 8] on August 31, 2018 (the “Petition Date”), and incorporated by reference into this Declaration. Further, I am familiar with the facts and circumstances related to the current KEIP and KERP as set forth more fully in my declaration in support of the *Debtors’ Motion and Memorandum of Points and Authority in Support of Approval of Debtors’ Key Employee Incentive Program and Key Employee Retention Program* [Docket No. 631].

¹⁴ Unless otherwise defined, capitalized terms used herein shall have the same meaning as in the Motion.

1 5. The KEIP/KERP Orders authorized three distinct bonus programs, which provided
2 different treatment for three different categories of Key Employees 1) KERP Participants, 2) Entity
3 KEIP Participants and 3) VHS KEIP Participants. Moreover, none of the Participants were entitled
4 receive bonuses under more than one Bonus Program.

5 6. On December 27, 2018, after the culmination of a marketing process that began
6 almost immediately after the Petition Date, the Court entered an order approving the sale of all
7 assets (excluding cash, accounts receivables and causes of action) of OCH and SLRH [Docket No.
8 1153] (the “SCC Sale”). Due to the significant efforts of the Debtors’ Key Employees, notably the
9 VHS KEIP Participants, who have not yet received any bonus, who made themselves constantly
10 available for diligence and transition issues with the buyer and who helped maintain the going-
11 concern value of those two hospitals pending closing, the SCC Sale closed on February 28, 2019,
12 resulting in \$235 million in proceeds to the Debtors’ estates.

13 7. The Debtors have also sold approximately \$2.4 million of Verity Medical
14 Foundation’s (“VMF”) assets in Court-approved transactions (the “VMF Transactions”). For
15 example, VMF entered into settlements and asset purchase agreements with Union Square Hearing,
16 Inc. [Docket Nos. 2439, 2693], San Jose Medical Group and Silicon Valley Medical Development,
17 LLC [Docket Nos. 1636, 1919], Oncology Technology Associates, LLC [Docket Nos. 1635, 1915],
18 and All Care Medical Group, Inc. [Docket Nos. 1180, 1368]. The Key Employees, particularly the
19 VHS KEIP Participants, were integral to this effort.

20 8. Certain Key Employees received KEIP and KERP payments as a result of the SCC
21 Sale and VMF Transactions. Employees under the KEIP (“KEIP Participants”) employed by OCH
22 and SLRH received the maximum bonus tied to the timing of the SCC Sale (15% of salary) in mid-
23 2019. During the SCC Sale process, the Debtors made retentive KERP Payments, with the final
24 payment (to employees in good-standing) made on or around June 30, 2019. KERP Participants
25 who were terminated by the Debtors but otherwise employed in good-standing at the time of the
26 closing of the SCC Sale received severance under the KERP. The Debtors did not make any
27 payments under the VHS KEIP because, under its terms, no payment was due at that time. To date,
28 the Debtors have paid a total of \$1,057,515 under the Entity KEIP and \$887,825 under the KERP.

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1 9. Since the termination of the SGM APA, the Debtors have focused their efforts on
2 implementing Plan B.

3 10. The Amendments propose specific relief to address specific concerns. True and
4 correct, copies, of the KEIP and KERP with the Amendments are attached to the Motion as
5 **Exhibits “A” and “B,”** respectively, as well as a) a true and correct copy of a chart demonstrating
6 the aggregated differences between amounts under the original Bonus Programs versus what is
7 being proposed under the Amendments that is attached to the Motion as **Exhibit “F”** to the Motion
8 and b) a true and correct copy of a chart demonstrating VHS KEIP payments for Sale Proceeds at
9 \$600 million and above that is attached as **Exhibit “G”** (filed under seal) to the Motion. The
10 Amendments are summarized here as follows:

11 a. **KERP Participants** will be entitled to receive from one of two bonus pools
12 totaling \$756,000: a) a pool of \$406,000 for standard bonus payments and b)
13 a pool of \$350,000 for discretionary payments. The pool for standard
14 payments provides up to 30% of each listed KERP Participants’ contractual
15 compensation, payable in two installments, i) 1/10 of the 30% bonus payable
16 within ten (10) business days of entry of the order approving the
17 Amendments and ii) the 9/10 balance payable upon the KERP Participant’s
18 termination. The discretionary pool may be used to provide as yet-identified
19 future KERP Participants, up to 30% of their salary. It should be noted that:

20 i. Maximum KERP payments, assuming the Debtors fully utilize the
21 Amended KERP Pool, under the Amendments total \$756,000, which
22 is \$363,000 more than the original KERP program.

23 ii. The amended KERP amounts are in addition to the three installment
24 payments of 6% each (18% total) that were paid up through June
25 2019.¹⁵ Therefore, if someone had been a KERP employee under the
26 original KERP and still remains employed through the end of the
27

28 ¹⁵ In addition to those three payments (which equal 18%) KERP employees could receive 12% upon termination. KERP employees who were terminated and received the 12% termination are not among the current KERP Participants.

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1 Cases, they may receive a total equal to 18% for past payments plus
2 30% for future payments.

3 b. **KEIP Participants** will continue to be organized into of two general groups:

4 i. **Entity Participants**, which is comprised of six (6) employees
5 (originally 16) whose assistance is needed to maintain the hospital
6 operations until the disposition of the facility in which he or she
7 works;

8 ii. **VHS Participants** which includes seven (7) employees (originally
9 nine), all of whose assistance is required to maximize value from the
10 disposition of all of VHS systems material assets (however long that
11 may take); certain of whom continue to constitute Upper-Level VHS
12 Participants.

13 c. **KEIP bonuses** payments depend upon the group they are in:

14 i. **Entity Participant bonuses** were comprised of two parts: 1) a
15 performance bonus measured against the budget relating to the
16 Debtor in Possession (DIP) Financing, which occurred and which
17 bonuses have been paid and 2) the disposition of the facility that
18 employ(s)(ed) them. As proposed, the Amendments provide:

19 ii. a bonus equal to 2.5% of each Entity Participant's respective salary
20 upon compliance with the existing cash collateral budget through
21 February 2020;

22 iii. a bonus equal to 22.5% of each Entity Participant's respective salary
23 upon termination without cause after the disposition of the hospital
24 that employs them.

25 d. **VHS Participant bonuses** were previously tied exclusively to total
26 recoveries of all VHS system assets. Because of SGM's refusal to close, not
27 all assets have been disposed and, thus, no bonuses have been paid to any
28 VHS Participants. To remedy,

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- 1 i. VHS Participants (currently seven (7) in total), five (5) of whom may
2 receive a total bonus equal to 50% of his or her annual salary, and the
3 two Upper-Level VHS Participants who may receive bonuses equal
4 to 100% of their respective annual salaries, as follows:
- 5 ii. 10% of salary value (20% for the Upper-Level VHS KEIP
6 Participants) is payable upon entry of an order approving a sale of
7 SFMC;
- 8 iii. Up to 40% of salary value (80% for the Upper-Level VHS KEIP
9 Participants) is payable upon disposition of all facilities with bonus
10 measured by the value of such assets sales, with the maximum tied
11 to an aggregate sale proceeds value of at least \$800 million (which
12 measurement includes the SCC Sale and the VMF Transactions) to
13 40% of salary value (80% for the Upper-Level VHS KEIP
14 Participants) is payable upon disposition of all facilities with bonus
15 measured by the value of such assets value, with the maximum tied
16 to an aggregate value of at least \$800 million (which measurement
17 includes the SCC Sale and the VMF Transactions)).
- 18 iv. The Upper-Level VHS Participants receive no additional incentive
19 for between the \$290 million of proceeds, already achieved through
20 the VMF, OCH and SLRH sales, and \$599 million. Therefore, if the
21 SFMC and SVMC sales do not generate incremental proceeds of at
22 least \$310 million, these participants will have earned no additional
23 incentive.

24 11. Throughout these Cases, the Debtors' Key Employees have worked to the benefit of
25 the Debtors' estates by overseeing and ensuring the continued efficient and effective operations of
26 the Debtors' hospitals, thereby providing medical care to thousands of patients and employment to
27 thousands of staff, while also preserving and maximizing value to creditors. Each Key Employee
28 has been critical to these efforts, including by interacting with potential purchasers, maintaining

1 effective operations, providing patient care, and maintaining doctor and employee morale. Key
2 Employees already have guided the Debtors toward the successful completion of the SCC Sale
3 (\$282.3 million in cash consideration) and VMF Transactions (\$7.6 million in consideration).
4 Although certain KEIP Key Employees were rewarded for their efforts in connections with those
5 transactions (and KERP Key Employees for remaining), significant work remains and the Debtors
6 must retain and incentivize Key Employees through 2020.

7 12. In fact, due to SGM's unexpected refusal to close a sale transaction for substantially
8 all of the Debtors' remaining non-cash assets, remaining Key Employees are now being called upon
9 to work harder and longer to effectuate Plan B. Among other things, Plan B requires Key
10 Employees to maintain patient care and operations at the Debtors' remaining hospitals, oversee the
11 liquidation at SVMC and concurrently coordinate multiple transactions for the Debtors' remaining
12 assets either as going-concern sales or alternative transactions for the benefit of the Debtors' estates.
13 Indeed, certain of the positions filled by Key Employees must remain staffed under California law
14 applicable to operating hospitals.

15 13. The need for the proposed Amendments is further warranted due to the increased
16 risk of attrition. This concern is well-founded. Even before these Cases, from August 30, 2017 to
17 August 30, 2018, more than 80 employees in leadership and other critical positions left the Debtors,
18 including four CEOs, one Chief Medical Officer, one Nurse Executive, eleven Vice Presidents,
19 three CFOs, and fourteen Clinical Directors/Managers. During these Cases, further attrition has
20 occurred as evidenced by several examples, including:

- 21 • VHS' Chief Financial Officer resigned;
- 22 • VHS' Chief Information Officer resigned;
- 23 • SMC lost its Chief Executive Officer, Chief Financial Officer and two successive
24 Chief Nursing Officers in 2019;
- 25 • the Debtors' hospitals have lost KERP-eligible positions of controller, executive
26 director of patient financial services, director of strategy/financial analysis and director of
27 hospital finance; and
- 28

1 • in 2019, total turnover was 15% at SMC, 14% at SFMC, and 46% at VHS (which
2 jumped from 27% as of September 2019 to 46% by the end of 2019), further adding to the
3 burden of the Key Employees.

4 14. This attrition has been paired with the Debtors' increasing difficulties with
5 recruitment and hiring of new talent, given that the Debtors are now undertaking Plan B.

6 15. Going forward, the Debtors face even more risks. Many Key Employees expected
7 to continue working in similar positions for SGM after the closing of the SGM Sale, and, therefore,
8 had an incentive to remain in the Debtors' employment through the then-expected December 2019
9 closing. Since the SGM Sale did not occur, such incentive no longer exists. In fact, the proposed
10 Amendments are meant to address, in part, the loss of that incentive caused by the loss of the SGM
11 Sale and the uncertainties presented by Plan B. The Debtors also will be asking each participant to
12 take on greater responsibilities and therefore, an increased amount of required work hours, in order
13 to maximize value to the estates.

14 16. The Debtors have determined, utilizing their reasonable business judgment, that the
15 Amendments are necessary to manage the orderly disposition of the remaining hospitals and assets
16 and otherwise maximize Plan B's value.

17 17. The retentive and incentivizing objectives of the current KERP and KEIP were
18 implemented with the expectation that the Debtors' going-concern sales would close in 2019. By
19 contrast, Plan B is an alternative strategy implemented as a result of SGM's refusal to close the
20 SGM Sale and the December 27, 2019 termination of the SGM APA. As such, without the
21 Amendments, the current structures of the KERP and KEIP are not designed to incentivize or retain
22 the Key Employees during the implementation of Plan B.

23 18. The Amendments are supported by my Declaration and the analysis, research and
24 information, including of market comparable and structuring, set forth in the Declaration Of
25 Christopher J. Kearns In Support Of Debtors' Motion For Entry Of Order Authorizing And
26 Approving (I) Key Employee Incentive Plan And (II) Key Employee Retention Plan; And Debtors'
27 Motion For Entry Of An Order Sealing Employee Information (the "Kearns Declaration") [Docket
28 631] appended to the KEIP/KERP Motion. The Debtors and their advisors, Berkeley Research

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1 Group, LLC (“BRG”), whose principals work closely with the Debtors in the management and
2 operations of the Debtors and are well-positioned to assess the Debtors’ acute need to retain and
3 incentivize the Key Employees, have developed the Amendments by considering the analysis set
4 forth in the Kearns Declaration to the changed circumstances of the Cases, the increased workload
5 (by sheer hours and by the demanding nature of the work especially considering the unforeseen loss
6 – and general inability to find replacements – of key personnel to date) now required by the Key
7 Employees for a successful Plan B, and the increased threat to Key Employee morale presented by
8 Plan B.

9 19. In addition, the need to promptly combat negative morale caused by the drastic
10 changes during the Debtors’ Cases—and the Debtors’ need for Key Employees to remain and
11 implement Plan B well into 2020—cannot be overstated. VHS KEIP Participants have shepherded
12 the Debtors through the closings of the SCC Sale and VMF Transactions, but have not received any
13 bonuses. Such Key Employees worked tirelessly to satisfy all conditions to closing the SGM Sale.
14 But for SGM’s failure to close, Key Employees would have received well-deserved bonuses in late
15 2019 or early 2020. Indeed, many Key Employees relied on the prospect of future employment in
16 a similar capacity upon the closing the SGM Sale—a possibility that is no longer available
17 following the failure of the SGM Sale. Absent approval of the Amendments, the threat of attrition
18 among Key Employees will greatly and quickly increase as the Cases continue and, it will be
19 difficult, perhaps impossible, to replace these persons under the circumstances.

20 20. If maximum bonuses are paid (meaning the Debtors’ key employees remain eligible
21 and help bring in Sale Proceeds equal to or exceeding \$800,000,000 in these Cases), the
22 Amendments in total represent an overall decline of \$725,000 from the existing Bonus Programs.
23 The proposed decrease is reflective of the attrition experienced with the participants (which have
24 not been replaced) under the Bonus Programs. Although total KERP payments may increase by
25 \$363,000, and bonuses for KEIP Entity Participants increase modestly by \$21,000, those increases
26 are more than offset by the \$1.1 million reduction in proposed payments to KEIP VHS Participants
27 from the original KEIP as reflected in **Exhibit “F”** to the Motion. Moreover, the current proposed
28 payments are appropriate in consideration of multiple months of extra labor under stressful

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1 conditions now required, greatly exceeding the demands contemplated under the current Bonus
2 Programs. The Key Employees must perform the demanding job of operating hospitals and
3 healthcare businesses, all while conducting sales and alternative transactions for each the hospitals.

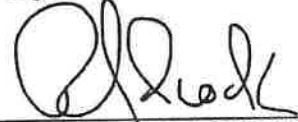
4 21. Further, while all of the Debtors' employees play a role in the Debtors' overall
5 financial success, the Debtors have limited the Amendments to employees (a tiny fraction of the
6 Debtors' current, total workforce) who manage the remaining hospitals and businesses and who are
7 critical to (a) the Debtors' ability to operate, sell, and if necessary, wind-down, the hospitals during
8 Plan B, (b) preserving the value of the Debtors' remaining assets, and (c) delivering high quality
9 patient care.

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1 I declare under penalty of perjury that, to the best of my knowledge and after reasonable
2 inquiry, the foregoing is true and correct.

3 Executed this 11th day of February 2020, at Los Angeles, California.

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6 RICHARD G. ADCOCK
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Exhibit "A"

KEIP

VERITY

SECOND AMENDED KEY EMPLOYEE INCENTIVE PLAN

1. Purpose

This Second Amended Key Employee Incentive Plan (“Second Amended KEIP”) is amended from that Key Employee Incentive Plan approved by the Bankruptcy Court on November 28, 2018 (the “Original KEIP”), as amended and approved by the Bankruptcy Court on November 8, 2019 (the “First Amended KEIP” and referred to along with the Original KEIP and the Second Amended KEIP as the “KEIP”). The KEIP is intended to provide incentives for certain employees of the Debtors to preserve and maximize value for the Debtors’ estates and stakeholders and is being sought for approval to reflect the changed circumstances of the Chapter 11 Cases, as those terms are defined below.

2. Definitions. Capitalized terms not defined above or otherwise herein shall have the following meanings.

(a) “Bankruptcy Code” means title 11 of the United States Code, 11 U.S.C. §§ 101, *et seq.*

(b) “Bankruptcy Court” means the United States Bankruptcy Court for the Central District of California, Los Angeles Division.

(c) “Budget Condition” means the Debtors’ compliance with the Cash Collateral Budget through February, 2020.

(d) “Cash Collateral” shall have the same meaning as in the Cash Collateral Order.

(e) “Cash Collateral Budget” shall have the same meaning as in the Cash Collateral Order, which for the avoidance of doubt, is defined therein and also herein as “as modified from time to time as permitted [in the Cash Collateral Order],” and, shall, for the avoidance of doubt, also include any other budgets approved by the Bankruptcy Court concerning Cash Collateral.

(f) “Cash Collateral Order” means the Final Order Approving Stipulation to (A) Amend Cash Collateral Agreement and Supplement Cash Collateral Order, (B) Authorize Continued Use of Cash Collateral, (C) Grant Adequate Protection, (D) Modify Automatic Stay, and (E) Grant Related Relief [Docket No. 4028], entered by the Bankruptcy Court in the Chapter 11 Cases and any amendment thereto, or any further order(s) entered by the Bankruptcy Court concerning the use of Cash Collateral.

(g) “Cause” shall mean (i) a KEIP Participant’s failure to materially perform the duties for which he or she is employed, (ii) a KEIP Participant’s willful violation of a material Debtors’ policy, (iii) a KEIP Participant’s commission of any act or acts of fraud, embezzlement, dishonesty or other willful misconduct, (iv) a KEIP Participant’s material breach of any of his or her obligations under any written agreement or covenant with the Debtors that employs him or her, (v) any willful or reckless disclosure by a KEIP Participant—or otherwise caused by a KEIP Participant—of confidential, proprietary, or otherwise nonpublic information concerning, without limitation, the Debtors, their affairs, their businesses, the Chapter 11 Cases, and/or all matters related to the Sale process or Chapter 11 Plan, or (vi) an act of dishonesty on the part of the KEIP

Participant resulting or intended to result, directly or indirectly, in his or her gain for personal enrichment at the expense of the Debtors.

(h) “Chapter 11 Cases” means those certain jointly administered cases under chapter 11 of the Bankruptcy Code currently pending in the Bankruptcy Court under Lead Case No. 18-20151.

(i) “Chapter 11 Plan” means any plan of reorganization or liquidation filed by the Debtors in the Chapter 11 Cases, including all exhibits thereto and as amended, supplemented, or otherwise modified from time to time.

(j) “Code” means the Internal Revenue Code of 1986, as it may be amended from time to time, including regulations and rules thereunder and successor provisions and regulations and rules thereto.

(k) “Debtor” or “Debtors” means, respectively, one or more debtor and debtor in possession in these Chapter 11 Cases.

(l) “Disability” means “disabled” within the meaning of Section 409A of the Code and the regulations issued thereunder.

(m) “Effective Date” shall have the meaning set forth in Section 7(c).

(n) “Entity KEIP Participant” means one or more of the individuals identified on the Entity KEIP Participant List.

(o) “Entity KEIP Participant List” means Schedule 2 as attached hereto as may be modified and amended from time to time.

(p) “KEIP Incentive Pool” shall have the meaning set forth in Section 6A.

(q) “KEIP Participant” means one or more of the individuals identified as participating in this Plan on a KEIP Participant List.

(r) “KEIP Participant Lists” means Schedule 1 and Schedule 2, as either or both may be modified and amended from time to time.

(s) “KEIP Payments” shall have the meaning set forth in Section 5.

(t) “Petition Date” means August 31, 2018.

(u) “Plan Effective Date” means the date upon which the Chapter 11 Plan goes into effect in accordance with the terms thereof.

(v) “Prior Payment” shall have the meaning set forth in Section 5.

(w) “Prior Sale Credit” means the amount of \$290 million.

(x) “Reorganized Debtor” and “Reorganized Debtors” means, respectively, one or more Debtor as it/they exist(s) as of the Plan Effective Date.

(y) “Respective Hospital” means, as applicable to a respective Entity KEIP Participant, the employer of that Entity KEIP Participant

(z) “Respective Hospital Sale Order” means an order entered by the Bankruptcy Court approving the sale of a Respective Hospital.

(aa) “Respective Hospital Trigger” shall mean, as applicable to an Entity KEIP Participant, the occurrence of one of the following: (i) a Respective Hospital Sale Order; (ii) a substantial wind-down of the Respective Hospital; or (iii) termination, without Cause, of the employment of the Entity KEIP Participant by the Respective Hospital.

(bb) “SFMC Sale Order” means an order entered by the Bankruptcy Court approving the sale of St. Francis Medical Center.

(cc) “Salary” means the applicable “Salary” amount listed for each KEIP Participant in the KEIP Participant Lists.

(dd) “Sale” means the sale of assets or equity in one or more Debtor.

(ee) “Sale Proceeds” means a) the Prior Sale Credit plus b) the total consideration attributable to any Sale; including realization from any excluded assets related to such Sales and/or the assumption of liabilities, whether received before or after the Plan Effective Date.

(ff) “Section 5 Condition” and “Section 5 Conditions” means, respectively, one or more of the conditions set forth in Section 5(a) and 5(b).

(gg) “Section 5 Trigger Date” and “Section 5 Trigger Dates” means, respectively, one or more of the trigger dates set forth in Section 5 of the KEIP.

(hh) “Upper-Level VHS KEIP Participants” means [REDACTED]

(ii) “Upper-Level VHS Earned Amount” means 20% of the Salary of the applicable Upper-Level VHS KEIP Participant.

(jj) “VHS” means Verity Health System of California, Inc.

(kk) “VHS Board” means the Board of Directors for VHS.

(ll) “VHS Earned Amount” means 10% of a VHS KEIP Participant’s Salary, provided that this KEIP Participant is not an Upper-Level KEIP Participant.

(mm) “VHS KEIP Participant” means one or more KEIP Participants identified on the VHS KEIP Participant List.

(nn) “VHS KEIP Participant List” means Schedule 1 attached hereto as may be modified and amended from time to time.

(oo) “VHS KEIP Potential” means the maximum amount set forth in the VHS KEIP Participant List that a VHS KEIP Participant may earn as KEIP Payments under Section 5A.

3. Rules of construction

- Singular terms include the plural and vice versa.
- The terms “and” and “or” shall mean and/or.

4. Administration

Subject to the terms of this KEIP, the VHS Board shall have exclusive authority to interpret, operate, manage and administer the KEIP in accordance with its terms and conditions. The VHS Board shall have full discretionary authority in all matters related to the discharge of their respective responsibilities and the exercise of their respective authority under the KEIP. All determinations, decisions, actions and interpretations made or taken by the VHS Board with respect to the KEIP shall be final, conclusive and binding on all KEIP Participants and all other persons having or claiming to have any right or interest in or under the KEIP. The VHS Board may consider such factors as it deems relevant to making or taking such decisions, determinations, actions and interpretations, including the recommendations or advice of any director, officer or employee of the Debtor or an affiliate and such attorneys, consultants and accountants as the VHS Board may select. A KEIP Participant may contest a decision or action by the VHS Board with respect to such KEIP Participant only on the grounds that such decision or action was arbitrary, capricious, or unlawful, and any review of such decision or action shall be limited to determining whether the VHS Board’s decision or action was arbitrary, capricious, or unlawful.

5. KEIP Award Opportunities

Subject to the limitations set forth in this KEIP, the Debtors or the Reorganized Debtors (as applicable) shall make payments to the KEIP Participants listed on the KEIP Participant Lists, in the manner and in the amounts as set forth below (collectively, the “KEIP Payments”):

A. VHS KEIP Participants:

i. Upon the entry of an SFMC Sale Order,

a. Each Upper-Level VHS KEIP Participant, if then-employed, will receive, in addition to his or her annual contractual compensation, his or her Upper-Level VHS Earned Amount;

b. Any VHS KEIP Participant who is not an Upper-Level VHS KEIP Participant if then-employed, will receive, in addition to his or her annual contractual compensation, his or her VHS Earned Amount.

ii. On the Plan Effective Date (or within 10 days of receipt of any applicable Sale Proceeds after the Plan Effective Date),

a. The Upper-Level VHS KEIP Participants whom is then employed, will receive, in addition to their annual contractual compensation:

I. At \$600 million of total sales proceeds (the “Minimum Excess Proceeds Threshold”), including SCC and VMF

proceeds, an incentive payment equal to 40% of base salary (the “Minimum Excess Bonus Amount”);

- II. For every dollar of sale proceeds above the Minimum Excess Proceeds Threshold an incentive amount of 0.0002% of Salary, and which amount, when added to the Minimum Excess Bonus Amount and the Upper-Level VHS Earned Amount, is capped at 100% of the Salary of the Upper-Level VHS KEIP Participant

b. Any other VHS KEIP Participant whom is then employed, will receive, in addition their annual contractual compensation

- I. At \$600 million of total sales proceeds (the “Minimum Excess Proceeds Threshold”), including SCC and VMF proceeds, an incentive payment equal to 20% of base salary (the “Minimum Excess Bonus Amount”);
- II. For every dollar of sale proceeds above the Minimum Excess Proceeds Threshold an incentive amount of 0.0001% of Salary, and which amount, when added to the Minimum Excess Bonus Amount and the VHS Earned Amount, is capped at 50% of the Salary of the VHS KEIP Participant

B. Entity KEIP Participants. Each Entity KEIP Participant listed on Schedule 2, in addition to received KEIP Payments and his or her contractual compensation, will receive:

- i. Upon the satisfaction of the Budget Condition, 2.5% of the Entity KEIP Participant’s Salary; and
- ii. Upon the satisfaction of the Respective Hospital Trigger, an additional 22.5% of the Entity KEIP Participant’s Salary.

For the avoidance of doubt, to the extent that an Entity KEIP Participant received one or more payments under and in accordance with the terms of the Original KEIP (a “Prior Payment”), such Prior Payment is not intended and does not operate as a credit or reduction against KEIP Payments under Section 5.B above.

6. KEIP Incentive Pool.

A. The “KEIP Incentive Pool” means a total of \$3,600,000, comprised of \$3,051,000 to pay VHS KEIP Participants in accordance with Section 5A and \$549,000 to pay Entity KEIP Participants in accordance with Section 5B.

B. The KEIP Incentive Pool shall be funded from (a) Cash Collateral and (b) through any cash that may become available that is not Cash Collateral.

Notwithstanding the above, and subject to Section 7(b) and (c) of this KEIP, if any KEIP Participant’s employment with the Debtor ends or terminates for any reason (other than for Cause or death or Disability of the KEIP Participant, as set forth under Section 7(b) and (c), respectively), prior to the occurrence of an applicable Section 5 Condition, the unearned portion

of the KEIP Incentive Pool applicable to such KEIP Participant, shall be reallocated to the KEIP Incentive Pool, or allocated in accordance with the Cash Collateral Budget by the VHS Board without further approval of the Bankruptcy Court.

7. Termination of Employment

(a) Subject to Section 7(b) and (c), any amount otherwise payable under the KEIP attributable to a not yet satisfied Section 5 Condition shall be forfeited by the KEIP Participant in the event a KEIP Participant's employment with a Debtor is terminated, or otherwise ends, terminates for any reason (including, without limitation, if such KEIP Participant resigns, quits, or otherwise ends his or her employment with a Debtor) prior to the satisfaction of each of the Section 5 Conditions and any unearned portion of the KEIP Incentive Pool allocable or not otherwise paid under Section 7(b) or (c) to such person may be removed from the KEIP Incentive Pool, returned to the Debtor and reallocated to the KEIP Incentive Pool or allocated in accordance with the Cash Collateral Budget as authorized by the VHS Board without further approval of the Bankruptcy Court.

(b) If a KEIP Participant's employment with a Debtor is terminated without Cause, then such KEIP Participant shall be entitled to receive the KEIP Payments that would have been earned under the KEIP had such KEIP Participant been employed through the occurrence of the Section 5 Conditions on the Section 5 Trigger Dates as set forth in Section 5.

(c) If a KEIP Participant's employment with a Debtor is terminated due to death or Disability (as determined by the Debtors or the Reorganized Debtors, as applicable) prior to the occurrence of a Section 5 Trigger Date, then such KEIP Participant shall be entitled to receive, in addition to the amount earned under any satisfied Section 5 Condition: (i) any KEIP Payments that would have been earned under the yet to occur Section 5 Trigger Date (the "Effective Date"), divided by (ii) the number of days from the Petition Date through the occurrence of the Effective Date, multiplied by (iii) the number of days from the Petition Date through the occurrence of the Effective Date during which such KEIP Participant was employed by the Debtor.

8. Release

All payments under the KEIP shall be contingent upon, and no payment under the KEIP shall be made to a KEIP Participant (or if deceased, the representative of such KEIP Participant's estate) unless and until the KEIP Participant (or his or her representative) has duly executed a full release of known and unknown claims that such KEIP Participant may have against the Debtors or the Reorganized Debtors in a form determined appropriate by the Debtors or the Reorganized Debtors (as applicable), which release has become effective and has not been revoked as of the first Section 5 Trigger Date as to which payment is made to such KEIP Participant. To the extent executed in connection with a Section 5 Trigger Date prior to the Plan Effective Date, the release will (i) require such participant's signature to be reaffirmed by the relevant KEIP Participant, and made applicable to all known and unknown claims accruing after the relevant Section 5 Trigger Date, on the Plan Effective Date; and (ii) as reaffirmed, become effective and non-revocable not later than the date that is ten (10) days following the Plan Effective Date. Such release will include, but not be limited to, (i) any claim against the Debtors or the Reorganized Debtors with respect to such employee's employment with any Debtor (other than accrued and unpaid salary, benefits, expense reimbursement, vacation and any indemnification or any rights to and under insurance) and (ii) if applicable, any claim, right, or interest to any previously unpaid amounts earned or accrued with respect to any previous plans, agreements, or policies related to retention, severance, bonuses (but not including payments that are made in the ordinary course for referral of new employees which

is sometimes called a referral bonus), or incentives. In the event that any release is not executed by the KEIP Participant (or if deceased, the representative of such KEIP Participant's estate) in accordance with this Section, any payments under this KEIP will be forfeited. This provision is without prejudice to the KEIP Participant seeking or receiving releases, waivers and exculpation under any Chapter 11 Plan.

9. Section 409A

The KEIP is intended to comply with, or satisfy an applicable exemption from, Section 409A of the Code and the KEIP shall be administered and interpreted in accordance with such intention.

10. Miscellaneous

(a) The KEIP shall constitute an unfunded, unsecured liability of the Debtors to make payments in accordance with the provisions of the KEIP, and no individual shall have any security interest, ownership interest, or other interest in any assets of the Debtors or the Reorganized Debtors (as applicable) in connection with the KEIP. Neither the establishment of the KEIP nor any obligation of the Debtors or the Reorganized Debtors (as applicable) to make payments under the KEIP shall be deemed to create a trust or a principal-agent relationship. This KEIP does not constitute a term or condition of employment and no KEIP Participant shall have any right to receive payments hereunder, except to the extent all conditions relating to the receipt of such payments have been satisfied.

(b) Nothing in the KEIP shall be construed or interpreted as giving any KEIP Participant the right to be employed or retained by a Debtor or a Reorganized Debtor (as applicable) for any period or otherwise or impair the right of the Debtors or the Reorganized Debtors (as applicable) to control their employees or to terminate the services of any employee at any time.

(c) Amounts payable under the KEIP shall not be considered wages, salaries, or compensation under any employee benefit plan, except pursuant to the written terms of the KEIP.

(d) The Debtors or the Reorganized Debtors (as applicable) shall be entitled to withhold from any amount due and payable by the Debtors or the Reorganized Debtors (as applicable) to any KEIP Participant (or secure payment from such KEIP Participant in lieu of withholding) the amount of any withholding or other tax due from the Debtor or the Reorganized Debtor (as applicable) with respect to any amount payable to such KEIP Participant under this KEIP.

(e) If a KEIP Participant becomes entitled to any payments under the KEIP, and if at such time such KEIP Participant has outstanding any debt, obligation, or other liability representing an amount owing to a Debtor or a Reorganized Debtor (as applicable) (whether or not such liability is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, or equitable), then the Debtors or the Reorganized Debtors (as applicable) may offset such amount against the amount otherwise distributable to such KEIP Participant to the extent permitted by applicable law.

(f) No person otherwise eligible to receive any payment under the KEIP shall have any rights to pledge, assign, transfer, sell, or otherwise dispose of all or any portion of such payments, either directly or by operation of law, including, without limitation, by execution, levy, garnishment, attachment, pledge, or bankruptcy. If a KEIP Participant is not living at the time any payments are otherwise payable to him or her in accordance with the KEIP, such payments

shall be paid as designated by the KEIP Participant by will or by the laws of descent and distribution.

(e) To the extent not inconsistent with any order of the Bankruptcy Court approving the KEIP, the KEIP made and actions taken thereunder shall be governed by and construed in accordance with the laws of the State of California, without reference to the principles of conflict of laws, except as superseded by applicable federal law. So long as the Bankruptcy Court has jurisdiction with respect to the Chapter 11 Cases, any dispute arising under the KEIP shall be resolved by the Bankruptcy Court.

Schedule 1

(Entity KEIP Participant List)

[FILED UNDER SEAL]

Schedule 2

(VHS KEIP Participant List including Upper-Level KEIP Participants)

[FILED UNDER SEAL]

Exhibit "B"

KERP

VERITY
FIRST AMENDED KEY EMPLOYEE RETENTION PLAN

1. Purpose

This First Amended Key Employee Retention Plan (the “Amended KERP”) is amended from that Key Employee Retention Plan approved by the Bankruptcy Court on or about November 8, 2018 (the “Original KERP” and referred to with the Amended KERP as the “KERP”). The KERP is intended to provide incentives for certain employees of the Debtors to preserve and maximize value for the Debtors’ estates and stakeholders and is being sought for approval to reflect the changed circumstances of the Chapter 11 Cases, as those terms are defined below.

2. Definitions. Capitalized terms not defined above or otherwise herein shall have the following meanings.

(a) “Bankruptcy Code” means title 11 of the United States Code, 11 U.S.C. §§ 101, *et seq.*

(b) “Bankruptcy Court” means the United States Bankruptcy Court for the Central District of California, Los Angeles Division.

(c) “Cash Collateral” shall have the same meaning as in the Cash Collateral Order.

(d) “Cash Collateral Order” means the *Final Order Approving Stipulation to (A) Amend Cash Collateral Agreement and Supplement Cash Collateral order, (B) Authorize Continued Use of Cash Collateral, (C) Grant Adequate Protection, (D) Modify Automatic Stay, and (E) Grant Related Relief* [Docket No. 4028] entered by the Bankruptcy Court in the Chapter 11 Cases and any amendment thereto, or any further order(s) entered by the Bankruptcy Court concerning the use of Cash Collateral.

(e) “Cause” shall mean (i) a KERP Participant’s failure to materially perform the duties for which he or she is employed, (ii) a KERP Participant’s willful violation of a material Debtor policy, (iii) a KERP Participant’s commission of any act or acts of fraud, embezzlement, dishonesty or other willful misconduct, (iv) a KERP Participant’s material breach of any of his or her obligations under any written agreement or covenant with the Debtor that employs him or her, (v) any willful or reckless disclosure by a KERP Participant—or otherwise caused by a KERP Participant—of confidential, proprietary, or otherwise nonpublic information concerning, without limitation, the Debtors, their affairs, their businesses, the Chapter 11 Cases, and/or all matters related to any sale or asset disposition, or (vi) an act of dishonesty on the part of the KERP Participant resulting or intended to result, directly or indirectly, in his or her gain for personal enrichment at the expense of the Debtors.

(f) “Chapter 11 Cases” means those certain jointly administered cases under chapter 11 of the Bankruptcy Code currently pending in the Bankruptcy Court under Lead Case No. 18-20151.

(g) “Chapter 11 Plan” means any plan of reorganization or liquidation filed by the Debtors in the Chapter 11 Cases, including all exhibits thereto and as amended, supplemented, or otherwise modified from time to time.

- (i) “Discretionary Payments” shall have the meaning set forth in Section 5B, *infra*.
- (j) “Discretionary Pool” shall have the meaning set forth in Section 6A, *infra*, including the Returned Amounts under the conditions set forth in Section 7, *infra*.
- (k) “Discretionary Pool Member” shall mean any employee VHS designates as being entitled to receive compensation from the Discretionary Pool.
- (l) “Debtor” or “Debtors” means, respectively, one or more debtor and debtor in possession in this Chapter 11 Case.
- (m) “Disability” means “disabled” within the meaning of Section 409A of the Code and the regulations issued thereunder.
- (n) “Future Participant” means one or more individuals who are a non-insider and are not a KERP Participant.
- (o) “KERP Approval Order” shall mean a final order of the Bankruptcy Court approving this Amended KERP, including with any other modifications made or ordered by the Bankruptcy Court to which the Debtors consent.
- (p) “KERP Participant” means one or more of the individuals identified on the KERP Participant List.
- (q) “KERP Participant List” means Schedule 1 attached hereto, as may be modified and amended from time to time.
- (r) “KERP Payment” means a Discretionary Payment or Standard Payment as described in Section 5, *infra*.
- (s) “Plan Effective Date” means the date upon which the Chapter 11 Plan goes into effect in accordance with the terms thereof.
- (t) “Prior Payments” means any payments made pursuant to the Original KERP.
- (u) “Reorganized Debtor” and “Reorganized Debtors” means, respectively, one or more Debtors as it/they exist(s) as of the Plan Effective Date.
- (v) “Retention Pool” means, collectively, the Standard Pool and the Discretionary Pool.
- (w) “Returned Amounts” shall have the meaning set forth in Section 7(a), *infra*.
- (x) “Salary” shall mean the respective annual salary of the applicable KERP Participant as listed on the KERP Participant List or, for, with respect to Future Participant, the Salary existing on the date that person is determined by VHS to be a Future Participant.
- (y) “Section 5 Condition” means one or more of the conditions set forth in Section 5, *infra*, and subject to Section 7, *infra*.

- (aa) “Standard Payments” shall have the meaning set forth in Section 5A, *infra*.
- (bb) “Standard Pool” shall have the meaning set forth in Section 6A, *infra*.
- (cc) “VHS” means Verity Health System of California, Inc.
- (dd) “VHS Board” means the Board of Directors for VHS.

3. Rules of construction

- Singular terms include the plural and *vice versa*.
- The terms “and” and “or” shall mean and/or.

4. Administration

Subject to the terms of this KERP, VHS shall have exclusive authority to interpret, operate, manage and administer the KERP in accordance with its terms and conditions. VHS shall have full discretionary authority in all matters related to the discharge of their respective responsibilities and the exercise of their respective authority under the KERP. All determinations, decisions, actions and interpretations made or taken by VHS with respect to the KERP shall be final, conclusive and binding on all KERP Participants and all other persons having or claiming to have any right or interest in or under the KERP. VHS may consider such factors as it deems relevant to making or taking such decisions, determinations, actions and interpretations, including the recommendations or advice of any director, officer or employee of the Debtor or an affiliate and such attorneys, consultants and accountants as VHS may select. A KERP Participant may contest a decision or action by the VHS Board with respect to such KERP Participant only on the grounds that such decision or action was arbitrary, capricious, or unlawful, and any review of such decision or action shall be limited to determining whether VHS’s decision or action was arbitrary, capricious, or unlawful; provided further, that a KERP Participant may not contest the award (or lack of an award) with respect to a Discretionary Payment.

5. KERP Award Opportunities. KERP Participants and other qualified non-insider employees are eligible to receive the following payment(s) under this KERP:

A. *Standard Payments*. Subject to the limitations set forth in this Amended KERP, the Debtors or the Reorganized Debtors (as applicable) shall make to the KERP Participants on the KERP Participant List (or any permitted substitution), in addition to his or her contractual compensation and any Prior Payments, a payment in an amount equal to 30% of his or her Salary (each a “Standard Payment” and collectively, the “Standard Payments”), as follows and under the following conditions:

2) 90% of the Standard Payments within ten (10) business days of the Plan Effective Date (a “Section 5 Trigger Date”); provided, however, that if a KERP Participant’s employment has been terminated without Cause or due to death or Disability (as described in Section 7, *infra*) prior to the Plan Effective Date, such payment shall be made within (10) business days of the date of the occurrence of such termination of employment.

B. *Discretionary Payments.* Subject to the limitations set forth in this KERP, the Debtors or the Reorganized Debtors (as applicable) may make, in the sole discretion of VHS, in addition to any Prior Payments, one or more payments to a Future Participant (or any permitted substitute), in an amount that shall not exceed 30% of that Future Participant’s (or substitute’s) base compensation (each a “Discretionary Payment” and collectively, the “Discretionary Payments”).

6. Retention Pool.

A. The Retention Pool includes, collectively, amounts sufficient to pay all Standard Payments totaling \$406,000 (the “Standard Pool”) and Discretionary Payments totaling (1) \$350,000 plus (2) any Returned Amounts (together, the “Discretionary Pool”).

B. The Retention Pool shall be funded from (a) Cash Collateral and (b) any cash that may become available that is not Cash Collateral.

7. Termination of Employment

(a) Subject to Section 7(b), any amount otherwise payable under the KERP attributable to a not yet satisfied Section 5 Condition shall be forfeited by the KERP Participant in the event a KERP Participant’s employment with a Debtor is terminated, or otherwise ends, terminates for any reason (including, without limitation, if such KERP Participant resigns, quits, or otherwise ends his or her employment with a Debtor) prior to the satisfaction of each Section 5 Condition and unearned portion of the Retention Pool allocable or not otherwise paid under Section 7(b) or (c) to such person may be removed from the Retention Pool, returned to the Debtor and reallocated to the Retention Pool (the “Returned Amounts”) or allocated in accordance with the Cash Collateral Budget as authorized by VHS without further approval of the Bankruptcy Court.

(b) If a KERP Participant’s employment with a Debtor is terminated due to death or Disability (as determined by the Debtors or the Reorganized Debtors, as applicable), prior to the occurrence of the applicable Section 5 Trigger Date, then such KERP Participant shall be entitled to receive, subject to execution of the release set forth in Section 8, *infra*, by the KERP Participant, or his or her representative, payments under Section 5B.

8. Release

All payments under the KERP shall be contingent upon, and no payment under the Amended KERP shall be made to a KERP Participant (or if deceased, the representative of such KERP Participant’s estate), unless and until the KERP Participant (or his or her representative) has duly executed a full release of known and unknown claims that such KERP Participant may have against the Debtors or the Reorganized Debtors in a form determined appropriate by the Debtors or the Reorganized Debtors (as applicable), which release has become effective and has not been

revoked as of the applicable Section 5 Trigger Date as if it were never executed. To the extent executed in connection with a Section 5 Trigger Date prior to the Plan Effective Date, the release will (i) require such KERP Participant's signature to be reaffirmed by the relevant KERP Participant, and made applicable to all known and unknown claims accruing after the relevant Section 5 Trigger Date, on the Plan Effective Date; and (ii) as reaffirmed, become effective and non-revocable not later than the date that is ten (10) days following the Plan Effective Date. Such release will include, but not be limited to, (i) any claim against the Debtors or the Reorganized Debtors with respect to such employee's employment with any Debtor (other than accrued and unpaid salary, benefits, expense reimbursement, vacation and any indemnification or any rights to and under insurance) and (ii) if applicable, any claim, right, or interest to any previously unpaid amounts earned or accrued with respect to any previous plans, agreements, or policies related to retention, severance, bonuses (but not including payments that are made in ordinary course for referral of new employees which is sometimes called a referral bonus), or incentives. Such release must be executed and be non revocable prior to the date that is fifteen (15) days following the occurrence of the Plan Effective Date (the "Release Date"). In the event that such release is not executed by the KERP Participant (or if deceased, the representative of such KERP Participant's estate) or is revoked by the KERP Participant prior to the Release Date in accordance with this Section, any payments under this KERP will be forfeited. This provision is without prejudice to the KERP Participant seeking or receiving releases, waivers and exculpation under any Chapter 11 Plan.

9. Section 409A

The KERP is intended to comply with, or satisfy an applicable exemption from, Section 409A of the Code of 1986, and the KERP shall be administered and interpreted in accordance with such intention.

10. Miscellaneous

(a) The KERP shall constitute an unfunded, unsecured liability of the Debtors to make payments in accordance with the provisions of the Amended KERP, and no individual shall have any security interest, ownership interest, or other interest in any assets of the Debtors or the Reorganized Debtors (as applicable) in connection with the Amended KERP. Neither the establishment of the Amended KERP nor any obligation of the Debtors or the Reorganized Debtors (as applicable) to make payments under the Amended KERP shall be deemed to create a trust or a principal-agent relationship. This Amended KERP does not constitute a term or condition of employment and no KERP Participant shall have any right to receive payments hereunder, except to the extent all conditions relating to the receipt of such payments have been satisfied.

(b) Nothing in the KERP shall be construed or interpreted as giving any KERP Participant the right to be employed or retained by a Debtor or a Reorganized Debtor (as applicable) for any period or otherwise or impair the right of the Debtors or the Reorganized Debtors (as applicable) to control their employees or to terminate the services of any employee at any time.

(c) Amounts payable under the KERP shall not be considered wages, salaries, or compensation under any employee benefit plan, except pursuant to the written terms of the KERP.

(d) The Debtors or the Reorganized Debtors (as applicable) shall be entitled to withhold from any amount due and payable by the Debtors or the Reorganized Debtors (as applicable) to any KERP Participant (or secure payment from such KERP Participant in lieu of

(e) If a KERP Participant becomes entitled to any payments under the KERP, and if at such time such KERP Participant has outstanding any debt, obligation, or other liability representing an amount owing to a Debtor or a Reorganized Debtor (as applicable) (whether or not such liability is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, or equitable), then the Debtors or the Reorganized Debtors (as applicable) may offset such amount against the amount otherwise distributable to such KERP Participant to the extent permitted by applicable law.

(f) No person otherwise eligible to receive any payment under the KERP shall have any rights to pledge, assign, transfer, sell, or otherwise dispose of all or any portion of such payments, either directly or by operation of law, including, without limitation, by execution, levy, garnishment, attachment, pledge, or bankruptcy. If a KERP Participant is not living at the time any payments are otherwise payable to him or her in accordance with the KERP, such payments shall be paid as designated by the KERP Participant by will or by the laws of descent and distribution.

(g) To the extent not inconsistent with any order of the Bankruptcy Court approving the KERP, the KERP and actions taken thereunder shall be governed by and construed in accordance with the laws of the State of California, without reference to the principles of conflict of laws, except as superseded by applicable federal law. So long as the Bankruptcy Court has jurisdiction with respect to the Chapter 11 Case, any dispute arising under the KERP shall be resolved by the Bankruptcy Court.

Schedule 1

(KERP Participant List)

[FILED UNDER SEAL]

Exhibit "C"

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Tuesday, November 13, 2018

Hearing Room 1568

10:00 AM

2:18-20151 Verity Health System of California, Inc.

Chapter 11

#34.00 HearingRE: [631] Motion /Notice of Motion For Entry of Order Authorizing and Approving (I) Key Employee Incentive Plan, and (II) Key Employee Retention Plan; Memorandum of Points and Authorities In Support Thereof; Declarations of Richard G. Adcock and Christopher J. Kearns Filed Concurrently Herewith (Maizel, Samuel)

Docket 631

Matter Notes:

11/13/2018

The tentative ruling will be the order.
Party to lodge order: Movant

POST PDF OF TENTATIVE RULING TO CIAO

Tentative Ruling:

11/9/2018

For the reasons set forth below, the Motion is GRANTED in its entirety.

Pleadings Filed and Reviewed:

- 1) Notice of Motion and Debtors' Motion for Entry of Order Authorizing and Approving (I) Key Employee Incentive Plan, and (II) Key Employee Retention Plan [Doc. No. 631] (the "Motion")
- 2) Order Granting Debtors' Motion for Entry of an Order Sealing Employee Information and Denying Evidentiary Objections Thereto [Doc. No. 735]
- 3) Official Committee of Unsecured Creditors' Response to [Motion] [Doc. No. 739]
- 4) United States Trustee Response to [Motion] [Doc. No. 769]

I. Facts and Summary of Pleadings

On August 31, 2018, Verity Health Systems of California ("VHS") and certain of

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its subsidiaries (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. On August 31, 2018, the Court entered an order granting the Debtors' motion for joint administration of the Debtors' Chapter 11 cases. Doc. No. 17.

The Debtors seek approval of a Key Employee Retention Plan ("KERP") and Key Employee Incentive Plan ("KEIP"). On November 1, 2018, the Court entered an order authorizing the Debtors to file under seal certain information in support of the Motion. *See* Order Granting Debtors' Motion for Entry of an Order Sealing Employee Information and Denying Evidentiary Objections Thereto [Doc. No. 735] and Final Ruling Granting Debtors' Motion for Entry of an Order Sealing Employee Information [Doc. No. 721]. The information filed under seal (the "Confidential Information") consists of the identity and salary of the twenty employees subject to the KERP, and the identity and salary of the twenty-five employees subject to the KEIP.

The Debtors have discussed the KERP and KEIP with the United States Trustee (the "UST") and the Official Committee of Unsecured Creditors (the "Committee"). The concerns of the Committee and the UST have been resolved through discussions and/or certain modifications that the Debtors have agreed to make to the KERP and KEIP. There are no unresolved objections to the Motion.

The KEIP is designed to incentivize key employees to obtain the maximum sales price for the Debtors' assets. KEIP participants are entitled to receive bonus payments, expressed as a percentage of their annual salary, if certain sale price benchmarks are achieved. The bonus payment structure varies depending upon each key employee's envisioned role in the sale process, and was developed in consultation with outside consultants.

Two pools of employees are eligible for the KEIP: (1) key employees of VHS (the "VHS Participants") whose assistance is required to maximize value from the sales of all of VHS' material assets, however long that may take; and (2) key employees of one of the hospitals or Verity Medical Foundation (the "Entity Participants"), whose assistance is needed to maintain operations until the sale of the particular facility in which he or she works.

If consideration for the sales is \$950 million or more, the nine KEIP VHS Participants are eligible to receive bonus payments aggregating approximately \$5.3 million (or 0.56% of the sales consideration).

KEIP Entity Participants receive bonus payments based upon (1) performance against the DIP budget and the (2) timing of the sale of their respective employers' business/assets (the longer the sale takes, the lower the bonus payment). The

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maximum KEIP payment for the sixteen Entity Participants is just below \$1.6 million.

The KERP is intended to facilitate the Debtors' continued operation until its assets can be sold by encouraging certain key employees to remain employed with the Debtors. The KERP is available to twenty employees and provides a maximum potential benefit of 30% of an employees' annual salary, based upon the following criteria: 6% of annual salary for retention through December 31, 2018; 6% of annual salary for retention through March 31, 2019; and 6% of annual salary for retention through June 30, 2019, plus 12% of annual salary in the event of separation by management.

The Debtors request that all amounts earned and payable under the KEIP and KERP be afforded administrative-expense priority pursuant to §§503(b), 503(c), and 507(a). Ally Bank, the DIP Lender, supports the funding of the KEIP and KERP through DIP financing proceeds.

II. Findings and Conclusions

A. The Debtor Has Shown Sufficient Business Justification for the Incentive Programs

Section 363(b)(1) authorizes the Debtors to use property of the estate, other than in the ordinary course of business, after notice and a hearing. The Debtors are required to articulate a business justification for use of estate property outside the ordinary course of business. *Walter v. Sunwest Bank (In re Walter)*, 83 B.R. 14, 19–20 (9th Cir. BAP 1988). Whether the articulated business justification is sufficient "depends on the case," in view of "all salient factors pertaining to the proceeding." *Id.* at 19–20.

Here, the Debtors have sufficiently articulated a business justification for making the bonus payments contemplated under the KEIP and KERP. The Debtors have shown that the bonus payments are required to retain key employees who are necessary to preserve the value of the Debtors' assets.

B. Application of the Dana Corp. Factors Supports Approval of the Incentive Programs

Courts have relied upon the following factors in evaluating key employee incentive and retention plans such as those at issue here:

- Is there a reasonable relationship between the plan proposed and the results to be obtained, i.e., will the key employee stay for as long as it takes for the debtor to reorganize or market its assets, or, in the case of a performance

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Chapter 11

incentive, is the plan calculated to achieve the desired performance? (emphasis added)

– Is the cost of the plan reasonable in the context of the debtor's assets, liabilities and earning potential?

– Is the scope of the plan fair and reasonable; does it apply to all employees; does it discriminate unfairly?

– Is the plan or proposal consistent with industry standards?

– What were the due diligence efforts of the debtor in investigating the need for a plan; analyzing which key employees need to be incentivized; what is available; what is generally applicable in a particular industry?

– Did the debtor receive independent counsel in performing due diligence and in creating and authorizing the incentive compensation?

In re Dana Corp., 358 B.R. 567, 576–77 (Bankr. S.D.N.Y. 2006).

The factors set forth in *Dana Corp.* are met here. First, the KEIP appropriately incentivizes participants by awarding bonuses to employees only after the Debtors achieve specific sales results. Payments under the KEIP are also tied to the efficiency of the sale, and the KEIP has been structured in a way that pushes participants to close the sale in a speedy fashion.

Second, the KEIP is reasonable in the context of the Debtors' assets, liabilities, and earning potential. The maximum payment available to the nine key executives under the KEIP amounts to less than 1% of the sales price. The Court finds that the KEIP comports with industry standards.

Third, the scope of the KEIP is fair and reasonable. The KEIP applies to only those employees whose efforts are critical to ensure a successful sale of the Debtors' assets. In addition, the KEIP has been carefully crafted to award different payments to different employees, depending upon their anticipated role in the sales process.

Fourth, the exhibits filed in support of the Motion establish that the Debtors have performed extensive due diligence in developing the KEIP and KERP. The incentive plans have been developed by the Debtors in consultation with Berkeley Research Group, the Debtors' financial advisors.

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Chapter 11

C. The Incentive Programs Meet the Requirements Imposed by §503(c)(3)

Section 503(c)(3) requires that payments to a debtor's employees outside the ordinary course of business be "justified by the facts and circumstances of the case" to be allowable as an administrative expense. The majority of courts have found that this standard is no different from the business judgment standard under §363(b). *See, e.g., Global Home Prods.*, 369 B.R. at 783-84; *In re Velo Holdings, Inc.*, 472 B.R. 201, 212 (Bankr. S.D.N.Y. 2012) (collecting cases); *In re Nobex Corp.*, 2006 WL 4063024, 2006 Bankr. (Bankr. D. Del. Jan. 19, 2006) (court concluded that section 503(c)(3) was nothing more than a reiteration of the standard under section 363 under which courts had previously authorized transfers outside the ordinary course of business based on the business judgment of the debtor).

Having found that the incentive plan payments are appropriate under §363(b)(1), the Court finds that the incentive plans also meet the standard set forth in §503(c)(3), and accordingly are allowable as an administrative expense.

III. Conclusion

Based upon the foregoing, the Motion is GRANTED in its entirety. The Debtor shall submit a conforming order, incorporating this tentative ruling by reference, within seven days of the hearing.

No appearance is required if submitting on the court's tentative ruling. If you intend to submit on the tentative ruling, please contact Jessica Vogel or Daniel Koontz at 213-894-1522. **If you intend to contest the tentative ruling and appear, please first contact opposing counsel to inform them of your intention to do so.** Should an opposing party file a late opposition or appear at the hearing, the court will determine whether further hearing is required. If you wish to make a telephonic appearance, contact Court Call at 888-882-6878, no later than one hour before the hearing.

Party Information

Debtor(s):

Verity Health System of California,

Represented By
Samuel R Maizel
John A Moe II
Tania M Moyron

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Tuesday, November 13, 2018

Hearing Room 1568

10:00 AM

CONT...

Verity Health System of California, Inc.

Chapter 11

Claude D Montgomery
Sam J Alberts

Exhibit "D"

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Wednesday, November 6, 2019

Hearing Room 1568

10:00 AM

2:18-20151 Verity Health System of California, Inc.

Chapter 11

#8.00 HearingRE: [3240] Motion Debtors' Notice of Motion and Motion for Entry of an Order Amending Key Employee Incentive Plan; Memorandum of Points and Authorities In Support Thereof; Declaration of Richard G. Adcock Filed Concurrently Herewith

Docket 3240

Matter Notes:

11/6/2019

The tentative ruling will be the order.
Party to lodge order: Movant

POST PDF OF TENTATIVE RULING TO CIAO

Tentative Ruling:

11/5/2019

For the reasons set forth below, the Motion is GRANTED in its entirety.

Pleadings Filed and Reviewed:

- 1) Debtors' Notice of Motion and Motion for Entry of an Order Amending Key Employee Incentive Plan [Doc. No. 3240] (the "Motion")
 - a) Declaration of Service by Kurtzman Carson Consultants, LLC Regarding Docket Numbers 3231, 3238 and 3240 [Doc. No. 3405]
- 2) Official Committee of Unsecured Creditors' Response to the Debtors' Motion for Entry of an Order Amending Key Employee Incentive Plan [Doc. No. 3418]
- 3) No opposition to the Motion is on file.

I. Facts and Summary of Pleadings

On August 31, 2018 (the "Petition Date"), Verity Health System of California ("VHS") and certain of its subsidiaries (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. On August 31, 2018, the

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Wednesday, November 6, 2019

Hearing Room 1568

10:00 AM

CONT... Verity Health System of California, Inc.

Chapter 11

Court entered an order granting the Debtors' motion for joint administration of the Debtors' Chapter 11 cases. Doc. No. 17. As of the Petition Date, the Debtors operated six acute care hospitals (the "Hospitals").

On November 28, 2018, the Court approved the Debtors' Key Employee Incentive Plan (the "Original KEIP") and Key Employee Retention Plan (the "KERP"). Doc. No. 893 (the "KEIP/KERP Order"). Under the Original KEIP, certain key employees of the Debtors' Hospitals are entitled to receive bonus payments if (1) the Debtors meet cash flow targets (the "Cash Flow Metric") and if (2) the Debtors close the sale of the Hospitals by specified deadlines (the "Closing Metric"). With respect to the Closing Metric, eligible employees are entitled to receive the following bonus payments:

- 1) 15% of annual salary if the sale closes by March 31, 2019;
- 2) 11% of annual salary if the sale closes by June 30, 2019;
- 3) 7.5% of annual salary if the sale closes by September 30, 2019; and
- 4) 3% of annual salary if the sale closes by December 31, 2019.

On February 28, 2019, the Debtors closed the sale of O'Connor Regional Hospital ("O'Connor") and Saint Louise Regional Hospital ("St. Louise") to Santa Clara County. Eligible employees of O'Connor and St. Louise have received their maximum KEIP bonuses.

The sale of the Debtors' four remaining Hospitals (the "Remaining Hospitals") to Strategic Global Management, Inc. ("SGM" and the "SGM Sale") has not yet closed. Debtors move to amend the Original KEIP to modify the trigger date for the 15% bonus that eligible employees are entitled to receive under the Closing Metric provision (the Original KEIP as amended, the "Amended KEIP"). The proposed amendment would allow seven management employees who work at the Remaining Hospitals (the "Amendment Employees") to receive a 15% bonus payment, provided that the SGM Sale closes on or before December 31, 2019. (Under the Original KEIP, the Amendment Employees are eligible to receive only a 3% bonus if the sale closes on or before December 31, 2019.) If the SGM Sale closes subsequent to December 31, 2019, the Amendment Employees will not receive any bonus under the Closing Metric. Debtors state that the SGM Sale has taken longer than was anticipated at the time the Original KEIP was drafted. According to the Debtors, the Original KEIP prejudices the Amendment Employees by limiting their bonuses solely because of the delay in the sale resulting from the California Attorney General's lengthy review

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Wednesday, November 6, 2019

Hearing Room 1568

10:00 AM

CONT... Verity Health System of California, Inc.

Chapter 11

process.

The Official Committee of Unsecured Creditors (the "Committee") has no objection to the Motion. No other opposition to the Motion is on file.

II. Findings and Conclusions

A. The Debtors are Authorized to Amend the KEIP

Amendment of a KEIP is appropriate where the amendment is sought as a result of circumstances beyond the control of the key employees. In the bankruptcy of LightSquared Inc., the debtors obtained approval of a KEIP that awarded key employees bonuses if the debtors confirmed a plan by a date certain. The LightSquared debtors' plan timeline was delayed by unforeseen circumstances, including regulatory delays from the Federal Communications Commission. The debtors sought to amend the KEIP to correspond with the delayed plan confirmation timeline. The Bankruptcy Court approved the proposed amendment and "authoriz[ed] LightSquared to modify and extend LightSquared's existing Key Employee Incentive Plan to accommodate the current facts and circumstances of the Chapter 11 Cases." *Order Authorizing LightSquared to Modify and Extend Existing Key Employee Incentive Plan*, Case No. 12-bk-12080, Doc. No. 2274 at *1 (Bankr. S.D.N.Y. Mar. 27, 2015).

Similar to the situation in LightSquared, the Debtors' timeline for closing the SGM Sale has been delayed by unanticipated regulatory issues. Pursuant to Cal. Corp. Code § 5914, the Debtors submitted the SGM Sale to the review of the California Attorney General (the "Attorney General"). The Debtors requested an expedited review process given their substantial and ongoing operating losses. Notwithstanding this request, the Attorney General used the maximum time permitted under the statute to conduct the review, even availing himself of the 45-day extension under Cal. Corp. Code § 5915.

Closing of the SGM Sale was further delayed by the Attorney General's attempt to impose conditions upon the SGM Sale in excess of the conditions which SGM had agreed to accept. [Note 1] The Asset Purchase Agreement under which SGM agreed to purchase the Hospitals (the "APA") provided that SGM would close the sale so long as any conditions imposed by the Attorney General under the review process set forth in Cal. Corp. Code § 5914 were substantially consistent with conditions that SGM had agreed to accept (the "Approved Conditions"). In the event that the Attorney General sought to impose conditions materially different from the Approved Conditions (the "Additional Conditions"), the APA provided that the Debtors would

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Wednesday, November 6, 2019

Hearing Room 1568

10:00 AM

CONT... Verity Health System of California, Inc.

Chapter 11

have an opportunity to seek a determination from the Court that the Hospitals could be sold free and clear of the Additional Conditions under § 363(f). The APA does not require SGM to close the sale unless the Debtors obtain a final, non-appealable order authorizing the sale free and clear of the Additional Conditions. Closing of the SGM Sale has been delayed by the need for the Debtors to seek to obtain a final, non-appealable order authorizing the sale free and clear.

The delays discussed above are not the fault of the key employees and were not anticipated at the time the Debtors designed the KEIP. As was the case in the LightSquared bankruptcy, it is appropriate to permit the Debtors to amend the KEIP.

B. Application of the *Dana Corp.* Factors Supports Approval of the Amended KEIP

Courts have relied upon the following factors in evaluating key employee incentive plans such as the plan at issue here:

- Is there a reasonable relationship between the plan proposed and the results to be obtained, i.e., will the key employee stay for as long as it takes for the debtor to reorganize or market its assets, or, in the case of a performance incentive, is the plan calculated to achieve the desired performance? (emphasis added)
- Is the cost of the plan reasonable in the context of the debtor's assets, liabilities and earning potential?
- Is the scope of the plan fair and reasonable; does it apply to all employees; does it discriminate unfairly?
- Is the plan or proposal consistent with industry standards?
- What were the due diligence efforts of the debtor in investigating the need for a plan; analyzing which key employees need to be incentivized; what is available; what is generally applicable in a particular industry?
- Did the debtor receive independent counsel in performing due diligence and in creating and authorizing the incentive compensation?

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Wednesday, November 6, 2019

Hearing Room 1568

10:00 AM

CONT... Verity Health System of California, Inc.

Chapter 11

In re Dana Corp., 358 B.R. 567, 576–77 (Bankr. S.D.N.Y. 2006).

The Amended KEIP is consistent with the factors set forth in *Dana Corp.* The only difference between the Amended KEIP and the Original KEIP, which was previously approved by the Court, is the enlargement of the date triggering bonus payments under the Closing Metric. As discussed above, the regulatory delays necessitating enlargement of this date were not anticipated at the time the KEIP was designed. Further, the circumstances necessitating enlargement are entirely outside the control of the key employees who benefit from the Amended KEIP. Therefore, the Amended KEIP satisfies the *Dana Corp.* factors for the same reasons that the Original KEIP did. [Note 2]

Specifically, the Amended KEIP appropriately incentivizes Amendment Employees by awarding bonuses under the Closing Metric only if the Debtors close the SGM Sale on or before December 31, 2019. The Amended KEIP is reasonable in the context of the Debtors' assets and liabilities. Compared to the Original KEIP, the incremental cost of the Amended KEIP is \$305,204. This amount is reasonable in the context of the \$610 million SGM Sale. The scope of the Amended KEIP is fair and reasonable. Only seven management employees who work at the four Remaining Hospitals are eligible to receive payments under the Amended KEIP. Finally, the Declaration of Richard G. Adcock, the CEO of VHS, establishes that the Debtors have conducted the requisite due diligence in developing the Amended KEIP.

C. The Amended KEIP Satisfies the Business Judgment Standard

Section 363(b)(1) authorizes the Debtors to use property of the estate, other than in the ordinary course of business, after notice and a hearing. The Debtors are required to articulate a business justification for use of estate property outside the ordinary course of business. *Walter v. Sunwest Bank (In re Walter)*, 83 B.R. 14, 19–20 (9th Cir. BAP 1988). Whether the articulated business justification is sufficient "depends on the case," in view of "all salient factors pertaining to the proceeding." *Id.* at 19–20.

Here, the Debtors have sufficiently articulated a business justification for the Amended KEIP. As stated above, the Amendment Employees are not responsible for the delays necessitating the enlargement of the date triggering the Closing Metric. The Amended KEIP is necessary to preserve morale as the Amendment Employees confront numerous complex issues while working to close the SGM Sale.

Section 503(c)(3) requires that payments to a debtor's employees outside the ordinary course of business be "justified by the facts and circumstances of the case" to be allowable as an administrative expense. The majority of courts have found that this

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Wednesday, November 6, 2019

Hearing Room 1568

10:00 AM

CONT... Verity Health System of California, Inc.

Chapter 11

standard is no different from the business judgment standard under §363(b). *See, e.g., Global Home Prods.*, 369 B.R. at 783-84; *In re Velo Holdings, Inc.*, 472 B.R. 201, 212 (Bankr. S.D.N.Y. 2012) (collecting cases); *In re Nobex Corp.*, 2006 WL 4063024 (Bankr. D. Del. Jan. 19, 2006) (concluding that § 503(c)(3) was nothing more than a reiteration of the standard under § 363 under which courts had previously authorized transfers outside the ordinary course of business based on the business judgment of the debtor).

Having found the payments under the Amended KEIP to be appropriate under § 363(b)(1), the Court finds that such payments also meet the standard set forth in § 503(c)(3). Payments under the Amended KEIP are therefore allowable as an administrative expense.

III. Conclusion

Based upon the foregoing, the Motion is GRANTED in its entirety. The Debtors shall submit a conforming order, incorporating this tentative ruling by reference, within seven days of the hearing.

No appearance is required if submitting on the court's tentative ruling. If you intend to submit on the tentative ruling, please contact Carlos Nevarez or Daniel Koontz at 213-894-1522. **If you intend to contest the tentative ruling and appear, please first contact opposing counsel to inform them of your intention to do so.** Should an opposing party file a late opposition or appear at the hearing, the court will determine whether further hearing is required. If you wish to make a telephonic appearance, contact Court Call at 888-882-6878, no later than one hour before the hearing.

Note 1

A more detailed description of the conditions is set forth in the *Memorandum of Decision Granting Debtors' Emergency Motion to Enforce the Sale Order* [Doc. No. 3446].

Note 2

See Final Ruling Authorizing Original KEIP [Doc. No. 814].

Party Information

Debtor(s):

Verity Health System of California, Represented By

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Wednesday, November 6, 2019

Hearing Room 1568

10:00 AM

CONT... Verity Health System of California, Inc.

Chapter 11

Samuel R Maizel
John A Moe II
Tania M Moyron
Claude D Montgomery
Sam J Alberts
Shirley Cho
Patrick Maxcy
Steven J Kahn
Nicholas A Koffroth

Exhibit "E1"

FILED & ENTERED
JAN 31 2011
CLERK U.S. BANKRUPTCY COURT
Central District of California
BY harris DEPUTY CLERK

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Samuel R. Maizel (CA Bar No. 189301)
Scotta E. McFarland (CA Bar No. 165391)
Mary D. Lane (CA Bar No. 071592)
PACHULSKI STANG ZIEHL & JONES
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smcfarland@pszjlaw.com
mlane@pszjlaw.com

Attorneys for Debtor and Debtor in Possession
Victor Valley Community Hospital

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
RIVERSIDE DIVISION

In re:

VICTOR VALLEY COMMUNITY HOSPITAL,

Debtor

Case No.: 6:10-bk-39537-CB

Chapter 11

**ORDER GRANTING MOTION OF
DEBTOR FOR ORDER APPROVING
A KEY EMPLOYEE INCENTIVE
PLAN AND AUTHORIZING
PAYMENTS THERE UNDER [Docket
No. 465]**

Hearing
Date: January 26, 2011
Time: 2:00 p.m.
Place: U.S. Bankruptcy Court
3420 Twelfth Street
Courtroom 303
Riverside, CA 92501-3819

Judge: Hon. Catherine E. Bauer

The Court, having considered the *Notice of Motion and Motion of Debtor for Order
Approving a Key Employee Incentive Plan and Authorizing Payments there under* (the "Motion")

PACHULSKI STANG ZIEHL & JONES LLP
ATTORNEYS AT LAW
LOS ANGELES, CALIFORNIA

1 [Docket No. 465], and the Oppositions filed thereto, and the arguments of counsel at the Hearing on
2 the Motion and finding good cause therefore,

3 IT IS HEREBY ORDERED that the Motion is granted.
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26 DATED: January 31, 2011
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United States Bankruptcy Judge

PACHULSKI STANG ZIEHL & JONES LLP
ATTORNEYS AT LAW
LOS ANGELES, CALIFORNIA

NOTE: When using this form to indicate service of a proposed order, **DO NOT** list any person or entity in Category I. Proposed orders do not generate an NEF because only orders that have been entered are placed on the CM/ECF docket.

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is:
10100 Santa Monica Boulevard, 11th Floor, Los Angeles, CA 90067

A true and correct copy of the foregoing document described [**PROPOSED**] **ORDER GRANTING MOTION OF DEBTOR FOR ORDER APPROVING A KEY EMPLOYEE INCENTIVE PLAN AND AUTHORIZING PAYMENTS THERE UNDER [Docket No. 465]** will be served or was served (a) on the judge in chambers in the form and manner required by LBR 5005-2(d); and (b) in the manner indicated below:

I. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING ("NEF") – Pursuant to controlling General Order(s) and Local Bankruptcy Rule(s) ("LBR"), the foregoing document will be served by the court via NEF and hyperlink to the document. On **January 28, 2011**, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following person(s) are on the Electronic Mail Notice List to receive NEF transmission at the email address(es) indicated below:

Service information continued on attached page

II. SERVED BY U.S. MAIL OR OVERNIGHT MAIL (indicate method for each person or entity served):

On **January 28, 2011**, I served the following person(s) and/or entity(ies) at the last known address(es) in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States Mail, first class, postage prepaid, and/or with an overnight mail service addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

By Federal Express

Catherine E. Bauer, Judge
United States Bankruptcy Court
3420 Twelfth Street – Courtroom 303
Riverside, California 92501-3819

Service information continued on attached page

III. SERVED BY PERSONAL DELIVERY, FACSIMILE TRANSMISSION OR EMAIL (indicate method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on _____ I served the following person(s) and/or entity(ies) by personal delivery, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on the judge will be completed no later than 24 hours after the document is filed.

Service information continued on attached page

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

January 28, 2011 Paige C. Doyle /s/ Paige C. Doyle
Date Type Name Signature

II. SERVED BY U.S. MAIL OR OVERNIGHT MAIL

United States Trustee

Misty Isaacson
Office of the United States Trustee
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Riverside, CA 92501

Attorneys for Official Committee of Creditors Holding Unsecured Claims

Richard K. Diamond
Danning, Gill, Diamond & Kollitz, LLP
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Los Angeles, CA 90067

Counsel for The Senior Associates Group

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Attn: Thomas E. Patterson, Esq. and
Martin R. Barash, Esq.
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Los Angeles, CA 90067

Counsel for Prime Healthcare Services Foundation, Inc.

Lee Shulman
Mark Bradshaw
Shulman Hodges & Bastian LLP
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Foothill Ranch, CA 92610

NOTE TO USERS OF THIS FORM:

- 1) Attach this form to the last page of a proposed Order or Judgment. Do not file as a separate document.
- 2) The title of the judgment or order and all service information must be filled in by the party lodging the order.
- 3) **Category I.** below: The United States trustee and case trustee (if any) will always be in this category.
- 4) **Category II.** below: List ONLY addresses for debtor (and attorney), movant (or attorney) and person/entity (or attorney) who filed an opposition to the requested relief. DO NOT list an address if person/entity is listed in category I.

NOTICE OF ENTERED ORDER AND SERVICE LIST

Notice is given by the court that a judgment or order entitled (*specify*) **ORDER GRANTING MOTION OF DEBTOR FOR ORDER APPROVING A KEY EMPLOYEE INCENTIVE PLAN AND AUTHORIZING PAYMENTS THERE UNDER [Docket No. 465]** was entered on the date indicated as "Entered" on the first page of this judgment or order and will be served in the manner indicated below:

I. SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING ("NEF") Pursuant to controlling General Order(s) and Local Bankruptcy Rule(s), the foregoing document was served on the following person(s) by the court via NEF and hyperlink to the judgment or order. As of **January 28, 2011**, the following person(s) are currently on the Electronic Mail Notice List for this bankruptcy case or adversary proceeding to receive NEF transmission at the email address(es) indicated below.

Service information continued on attached page

II. SERVED BY THE COURT VIA U.S. MAIL: A copy of this notice and a true copy of this judgment or order was sent by United States Mail, first class, postage prepaid, to the following person(s) and/or entity(ies) at the address(es) indicated below:

Sophia Margetis
Pachulski Stang Ziehl & Jones LLP
10100 Santa Monica Boulevard, Suite 1100
Los Angeles, CA 90067

Service information continued on attached page

III. TO BE SERVED BY THE LODGING PARTY: Within 72 hours after receipt of a copy of this judgment or order which bears an "Entered" stamp, the party lodging the judgment or order will serve a complete copy bearing an "Entered" stamp by U.S. Mail, overnight mail, facsimile transmission or email and file a proof of service of the entered order on the following person(s) and/or entity(ies) at the address(es), facsimile transmission number(s), and/or email address(es) indicated below:

Service information continued on attached page

I. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING ("NEF")

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Thomas M Geher on behalf of Creditor Federal Deposit Insurance Corporation
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Scott E Gizer on behalf of Creditor Federal Deposit Insurance Corporation
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Mishaela J Graves on behalf of Creditor JPMorgan Chase Bank, National Association, successor in interest from the Federal Deposit Insurance Corporation, as receiver for Washington Mutual Bank, its assignees and/or successors
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John P Kreis on behalf of Interested Party Courtesy NEF
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Gilbert B Weisman on behalf of Creditor American Express Bank FSB
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III. SERVED BY U.S. MAIL OR OVERNIGHT MAIL

United States Trustee

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Riverside, CA 92501

Attorneys for Official Committee of Creditors Holding Unsecured Claims

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Counsel for The Senior Associates Group

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Attn: Thomas E. Patterson, Esq. and
Martin R. Barash, Esq.
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Los Angeles, CA 90067

Counsel for Prime Healthcare Services Foundation, Inc.

Lee Shulman
Mark Bradshaw
Shulman Hodges & Bastian LLP
26632 Towne Centre Drive, Ste. 300
Foothill Ranch, CA 92610

Exhibit "E2"

1 Samuel R. Maizel (CA Bar No. 189301)
2 Scotta E. McFarland (CA Bar No. 165391)
3 Mary D. Lane (CA Bar No. 071592)
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5 10100 Santa Monica Blvd., 11th Floor
6 Los Angeles, California 90067-4100
7 Telephone: 310/277-6910
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9 E-mail: smaizel@pszjlaw.com
10 smcfarland@pszjlaw.com
11 mlane@pszjlaw.com

12 Attorneys for Debtor and Debtor in Possession Victor
13 Valley Community Hospital

14 **UNITED STATES BANKRUPTCY COURT**
15 **CENTRAL DISTRICT OF CALIFORNIA**
16 **RIVERSIDE DIVISION**

17 In re:
18 VICTOR VALLEY COMMUNITY
19 HOSPITAL,
20
21 Debtor.

Case No. 6:10-39537 CB

Chapter 11

**NOTICE OF MOTION AND MOTION OF
DEBTOR FOR ORDER APPROVING A
KEY EMPLOYEE INCENTIVE PLAN
AND AUTHORIZING PAYMENTS
THERE UNDER; MEMORANDUM OF
POINTS AND AUTHORITIES; AND
DECLARATIONS OF KATHY DAVIS
AND SCOTTA E. McFARLAND IN
SUPPORT THEREOF**

Hearing

Date: January 26, 2011

Time: 2:00 p.m.

Place: U.S. Bankruptcy Court

3420 Twelfth Street

Courtroom 303

Riverside, CA 92501-3819

Judge: Hon. Catherine E. Bauer

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25 **TO THE HONORABLE CATHERINE E. BAUER, UNITED STATES BANKRUPTCY**
26 **JUDGE, THE LIMITED SERVICE LIST, COUNSEL FOR THE OFFICIAL**
27 **COMMITTEE OF UNSECURED CREDITORS, THE OFFICE OF THE UNITED STATES**
28 **TRUSTEE, AND PARTIES REQUESTING SPECIAL NOTICE:**

1 **PLEASE TAKE NOTICE** that Victor Valley Community Hospital, the above-captioned
2 debtor and debtor in possession (the “Debtor”), hereby moves (the “Motion”) the Court, pursuant to
3 sections 105(a), 363(b) and 503(c)(3) of title 11 of the United States Code (the “Bankruptcy Code”),
4 for the entry of an order approving a performance-based key employee incentive plan (the “Incentive
5 Plan”), and authorizing the Debtor to make payments there under.

6 **PLEASE TAKE FURTHER NOTICE** that the Incentive Plan will provide up to
7 approximately \$286,000¹ in total payments (a reasonable amount in the context of this case and the
8 \$37,000,000 purchase price offered for the Debtor’s assets) if certain specified milestones, as
9 discussed below and in more detail in the attached Memorandum of Points and Authorities, are met.
10 Beginning well before September 13, 2010, the date the Debtor filed its voluntary chapter 11
11 petition, the Debtor relied on and continues to rely on the Officers to discharge significant
12 responsibilities related to its chapter 11 case in addition to their regular duties. The Officers will
13 play an integral role in providing a smooth transition of the hospital operated by the Debtor (the
14 “Hospital”) to the buyers (“VHA”) pursuant to the sale approved by this Court at a hearing held on
15 November 9, 2010. After the sale of the Hospital is complete, the nature of the Officer’s duties will
16 change as they will be asked to take on the responsibilities associated with winding down the estate
17 in an efficient and timely manner for the benefit of all creditors and other interested parties. The
18 Officers’ particular knowledge and expertise with respect to the Debtor and the Hospital make them
19 the optimal parties to assist the Debtor in these endeavors. The Incentive Plan is designed to
20 incentivize the Officers to perform the additional and different duties to the best of their abilities and
21 in a timely fashion.

22 **PLEASE TAKE FURTHER NOTICE** that the Incentive Plan is based on several
23 milestones, each of which will enhance the value of the estate. The milestones are as follows: (1)
24 the closing of the sale of the Hospital, (2) the filing of a liquidating plan by not later than one month
25 after the closing of the sale of the Hospital, (3) the confirmation of the liquidating plan within two
26 months after the plan is filed, and (4) having the claims review process completed and all objections

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28 ¹ This amount is equal to ½ the annual salaries of the two officers who are to receive the payments. Under the Incentive Plan, if all of the milestones are met, each of the officers will receive a total incentive bonus of ½ of her/his current annual salary.

1 to claims filed by no later than three months after the liquidating plan is confirmed by the
2 Bankruptcy Court. One-fourth of the total bonus amount for each Officer will be earned after each
3 milestone is reached but will not be paid until the Officer's respective term of employment ends.
4 The Incentive Plan, by providing incentives for these key Officers to timely perform the increased
5 and different tasks required of them during the chapter 11 process, will create value for all
6 constituents.

7 **PLEASE TAKE FURTHER NOTICE** that the Motion is based on the attached
8 Memorandum of Points and Authorities and Declaration of Kathy Davis, the Declaration of Scotta E.
9 McFarland and any other admissible evidence properly brought before the Court. In addition, the
10 Debtor requests that the Court take judicial notice of the *Declaration of Edward Matthews Filed in*
11 *Support of Emergency Motions* [Docket No. 12] and all documents filed with the Court in this
12 chapter 11 case.

13 **PLEASE TAKE FURTHER NOTICE** that a hearing will be held on January 26, 2011 at
14 2:00 p.m. before the Honorable Catherine E. Bauer, Courtroom 303, 3420 Twelfth Street, Riverside,
15 California to consider the Motion. Local Bankruptcy Rule 9013 requires that any response to the
16 Motion shall be filed with the Bankruptcy Court and served upon the counsel for Debtor at the
17 address appearing on the upper-left hand corner of the caption page to this Motion within fourteen
18 (14) days after the date of service of the Motion. Pursuant to Local Bankruptcy Rule 9013-1(h), the
19 failure to timely file and serve written opposition may be deemed by the Court to be consent to the
20 granting of the relief requested in the Motion and the relief sought in this Motion may be granted
21 without further notice

22 **WHEREFORE**, the Debtor respectfully requests that the Court enter an Order (i) granting
23 the Motion, (ii) approving the Incentive Plan, (iii) authorizing the Debtor to pay the Incentive Plan
24 payments as they become due, and (iv) granting such other and further relief as it deems necessary
25 and appropriate.

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1 Dated: January 5, 2011

PACHULSKI STANG ZIEHL & JONES LLP

2

By /s/ Scotta E. McFarland

3

Samuel R. Maizel

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Scotta E. McFarland

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Mary D. Lane

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Attorneys for Victor Valley Community
Hospital, Debtor and Debtor in Possession,
Debtor and Debtor in Possession

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PACHULSKI STANG ZIEHL & JONES LLP
ATTORNEYS AT LAW
LOS ANGELES, CALIFORNIA

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1 MEMORANDUM OF POINTS AND AUTHORITIES

2 I.

3 INTRODUCTION

4 The Incentive Plan², which provides for the payment of cash bonuses based upon the
5 achievement of four milestones, is for the two officers of the Debtor, the chief executive officer and
6 the chief financial officer (the "Officers"), who will play an integral role in closing the sale of the
7 Hospital and winding-down the estate, therefore, maximizing value for all constituents in this
8 chapter 11 case. The Officers are being asked to perform duties that are in addition to and different
9 from their regular duties associated with operating the Hospital. They have the overall knowledge
10 and expertise regarding the Hospital's operations needed to direct the entire Hospital team in its
11 efforts to comply with the covenants contained in the Asset Sale Agreement approved by the Court,
12 assist the purchaser in obtaining the regulatory approval needed to close the sale of the Hospital,
13 propose a liquidating plan, and review and analyze the claims filed against the Debtor in this chapter
14 11 case. The Incentive Plan is based on accomplishing four milestones, each of which will enhance
15 the value of the estate. The total bonuses to be paid under the Incentive Plan, depending on the
16 number of milestones met, will be between \$0 and \$286,000, a reasonable amount considering the
17 \$37 million sale price for the Hospital and the potential for a plan that pays all creditors in full.
18 Therefore, the Incentive Plan is reasonable and justified under the facts of this chapter 11 case.

19 II.

20 JURISDICTION AND VENUE

21 The Court has jurisdiction over the Motion pursuant to 28 U.S.C. §§ 157 and 1334. Venue is
22 proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409. This is a core proceeding pursuant to
23 28 U.S.C. § 157(b)(2). The statutory predicate for the relief requested herein is sections 105(a),
24 363(b) and 503(c)(3) of the Bankruptcy Code.

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² Capitalized terms not otherwise defined in this Memorandum of Points and Authorities shall have the meaning given
them in the *Motion of Debtor for Order Approving a Key Employee Incentive Plan and Authorizing Payments There
Under* (the "Motion").

1 III.

2 BACKGROUND

3 A. General Case Background

4 On September 13, 2010 (the “Petition Date”), the Debtor filed a voluntary petition for relief
5 under chapter 11 of the Bankruptcy Code . The Debtor continues to operate its business and manage
6 its affairs as a debtor in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.
7 No trustee or examiner has been appointed in this chapter 11 case. On September 24, 2010, the
8 Office of the United States Trustee appointed an official committee of unsecured creditors (the
9 “Committee”).

10 B. The Debtor

11 The Debtor, a California nonprofit public benefit corporation founded in 1967, operates the
12 Victor Valley Community Hospital (the “Hospital”), the only nonprofit community hospital in the
13 California High Desert. The Hospital was designed and constructed as an acute care hospital, and
14 over the years it has been renovated and expanded to accommodate the needs of its patients and the
15 communities it serves, which include Adelanto, Apple Valley, Hesperia and Victorville.

16 As of the Petition Date, the Hospital was staffed to operate approximately 65 beds on a
17 normal day, although it has access to visiting nurse registries, which allow it to quickly increase its
18 staff to meet patient needs. Approximately 257 doctors from the local community have privileges at
19 the Hospital. As of the Petition Date, the Debtor employed approximately 572 people. Of this,
20 approximately 160 are nurses. The rest include, but are not limited to, office staff, technicians,
21 maintenance staff, IT staff, human resources staff, and Quality Assurance staff.

22 As an acute care facility, the Debtor provides a full range of inpatient and outpatient specialty
23 services, including, but not limited to, basic 24-hour emergency room services, surgical services,
24 pediatric services, operating room services, physical therapy, respiratory therapy, outpatient
25 ambulatory services, catheterization laboratory, diagnostic services, women’s health center and
26 outpatient imaging services, laboratory and pathology services, social and Medi-Cal eligibility
27 services, physician referral service, and community wellness and education programs. The Debtor
28 treats approximately 2,900 patients per month in the Emergency Room, of which approximately 250

1 are eventually admitted to the Hospital. Annually, the Debtor has approximately 6,600 patients
2 admitted to the Hospital, not including newborns. Doctors working in the Hospital perform
3 approximately 2,500 out-patient surgeries and approximately 2,000 in-patient surgeries and deliver
4 approximately 1,400 babies annually.

5 The Debtor is governed by a Board of Directors (the "Board") that is comprised of six
6 members who are leaders in the High Desert community: Kathy Davis, Chair (retired political
7 consultant); Dennis G. Killion, Vice-Chair (educator); Thomas Brown (retired bank president);
8 Michael Fermin (Deputy District Attorney); Tim Jasper (local business owner); and Herbert
9 Williamson, III (Public Defender).

10 **C. The Chief Executive Officer and the Chief Financial Officer**

11 The Debtor's Chief Executive Officer is Cathy Pelley, who has served in this position since
12 July 2009. Prior to that, she was a consultant for the Hospital for the previous four months; CEO at
13 Glendale Memorial Hospital in Glendale, California; and CEO at St. Mary's Regional Medical
14 Center in Apple Valley, California. She is a veteran, having served as an Army nurse during the
15 Vietnam War. She has a Nursing Degree from Philadelphia General Hospital, a Bachelor of Science
16 degree in Business Administration and a Master of Science degree in Organization Development,
17 both from the University of San Francisco, and has worked in the hospital industry since
18 approximately 1970, including more than 40 years as a CEO or equivalent position.

19 The Debtor's Chief Financial Officer and Chief Information Officer is Edward Matthews.
20 He has served in this position since December 2008. Prior to that, he was the founder of and served
21 as the principal manager for Neved Investments; the Chief Financial Officer for St. Johns Regional
22 Medical Center in Oxnard, California; a principal with Healthcare Marketing Group, a healthcare
23 industry investment banking group, and the Chief Financial Officer of Doctors' Hospital of
24 Montclair, in Montclair, California. He also served in the United States Army during the Vietnam
25 War, including service in Vietnam, and was awarded the Bronze Star Medal. He has a degree in
26 Business Administration, with a concentration in Accounting, and a Masters of Business
27 Administration, both from the University of Texas at Arlington. He has worked in the hospital
28 industry since 1975.

1 **D. Factors Leading to the Filing of the Chapter 11 Case**

2 The fiscal crisis that caused the Debtor to file its chapter 11 case is the result of the
3 confluence of several factors, none of which related to the management of the Hospital. First, the
4 Debtor provides millions of dollars per year in care to indigents, for which it is not compensated at
5 all or is inadequately compensated. The percentage of the Debtor's resources expended on indigent
6 care was increasing because the Debtor serves a depressed community and the economic condition
7 of this community has worsened in the past few years. As the unemployment rate has risen, so has
8 the number of uninsured patients. Over the last year, the volume of patients has not increased
9 substantially, however, the number of Medi-Cal and self-pay patients increased by 7%.

10 Second, the Hospital's plant is approximately 45 years old and the maintenance costs for this
11 plant are substantial and increasing every year. In addition to the maintenance costs, the costs of
12 bringing and keeping the hospital plant in compliance with the various governmental regulatory
13 requirements is also substantial.

14 Third, Medi-Cal arbitrarily reduced its payment rate by 10% in January 2010, and Medicare
15 payment rates will be reduced by 2.9% in October 2010. These changes caused a decline in the
16 Debtor's revenues without a corresponding reduction in the Debtor's obligations to provide patient
17 care.

18 Fourth, California's financial crisis and the inability of its legislature to pass a budget has
19 caused uncertainty in the timing and the amounts of the DSH Payments and a delay in the hoped for
20 Quality Assurance Fee payments.

21 Fifth, being a stand alone, small rural hospital in California is simply not an advantageous
22 financial situation. Such hospitals, including the Hospital, suffer from a lack of economies of scale,
23 poor payor mix, high overhead costs, less high-margin specialty service lines, and an overall lower
24 revenue base. Thus, the Hospital, like many rural small hospitals, struggles to meet even the
25 relatively small (1 - 3 %) profit margins that is the norm for most of the
26 not-for-profit hospital industry.

27 During the relatively short period of time prior to the filing of the chapter 11 case that the
28 Officers managed the Hospital they made extensive efforts to deal with the financial crisis,

1 including, but not limited to, laying off staff and changing to outsourcing for medical transcriptions.
2 They attempted to negotiate an increase in payor rates from Inland Empire Health Plan, a public
3 entity, and attempted to re-negotiate commercial contracts, however, they lacked leverage and were
4 not able to increase those contract rates. In any event, because 75% of the Debtor's payments come
5 from governmental payors, even an increase in payment rates from HMOs/PPOs would not make a
6 significant difference in the Hospital's cash flow.

7 Despite the efforts made by management, the Hospital's cash flow levels could not be
8 increased to a level sufficient for the Hospital to continue its operations. The Officers and the Board
9 determined that the Hospital would have to close absent drastic measures. Representatives of the
10 Board approached Prime Healthcare Services Foundation, Inc. ("Prime"), which had previously
11 expressed an interest in purchasing the Hospital, and an Asset Sale Agreement was negotiated which
12 was presented as part of the initial bankruptcy filings.

13 **E. The Sale of the Debtor's Primary Assets**

14 On September 14, 2010, the Debtor filed its *Motion for the Entry of an Order (A) Approving*
15 *Sale Procedures in Connection With Sale of Victor Valley Community Hospital; (B) Scheduling an*
16 *Auction for the Sale and a Hearing to Approve the Sale; (C) Authorizing the Sale Free and Clear of*
17 *Liens, Claims, Encumbrances and Interests; and (D) Granting Related Relief* [Docket No. 22]. The
18 Court entered an order on October 7, 2010 (the "Sale Procedures Order") [Docket No. 103],
19 approving sale procedures regarding the sale of the Hospital and specified related assets (the
20 "Assets"). Pursuant to the Sale Procedures Order, the Debtor held an auction of the Assets on
21 November 5, 2010, and two qualified bidders participated in the auction. VHA was the successful
22 bidder, bidding \$37 million dollars. The Court approved the sale of the Assets, pursuant to the
23 *Order (1) Authorizing the Sale of Substantially All of the Debtor's Assets Free and Clear of Liens,*
24 *Claims, Encumbrances and Interests, (2) Authorizing the Assignment of Certain Obligations of the*
25 *Debtor to Purchasers, (3) Finding That Purchasers Are Good Faith Purchasers, and (4) Granting*
26 *Related Relief* [Docket No. 351] entered on December 3, 2010.

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1 **F. Requirements of the ASA**

2 The ASA contains many obligations and covenants that the Debtor must perform as well as
3 conditions that must be met by the Debtor in order for the sale of the Hospital to close. In order to
4 avoid a breach by the Debtor of the ASA, the Debtor must perform under its terms, which
5 performance includes, but are not limited to, the following: (1) furnishing VHA additional financial
6 and operating data and other information regarding businesses and properties of the Hospital; (2)
7 carrying on the business of the Hospital, maintaining the Hospital, performing all material
8 obligations under certain contracts and leases of the Hospital, and using reasonable efforts to
9 maintain the Hospital's respective business organizations and its relationships with physicians,
10 suppliers, customers and others having business relationships with the Hospital; (3) cooperating with
11 VHA in its efforts to obtain all approvals and licenses; (4) delivering to VHA monthly unaudited
12 financial statements; (5) filing all Medicare, Medi-Cal, TRICARE, Blue Cross and other termination
13 cost reports required; and (6) using reasonable efforts to obtain all governmental and regulatory
14 agency approvals necessary for the closing of the sale of the Hospital. The Officers are key to the
15 performance of each of the covenants in the ASA and, therefore, to the closing of the sale of the
16 Hospital for the benefit of all parties.

17 The conditions to VHA's obligation to close the sale include, but are not limited to, the
18 following: (1) the Debtor must sign and deliver all documents, instruments and certificates as
19 required by the ASA; (2) the Debtor must have performed or complied with, in all material respects,
20 all obligations, covenants, agreements, and conditions of the Debtor in the ASA; and (3) the
21 California Attorney General shall have approved the sale of the Hospital to VHA.³ As with the
22 covenants, because of the Officers' knowledge of the Hospital, the Attorney General's requirements
23 and the ASA, their involvement in the satisfaction of these and the other conditions to the closing of
24 the sale is essential.

25 **G. Winding Down the Estate**

26 After the sale of the Hospital has closed and most of the Hospital's employees have become
27 employees of VHA, the chapter 11 case will continue. In fact, it is likely that the only two

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³ The approval of the Attorney General was received on December 31, 2010.

1 employees of the Debtor who will remain are the Officers. The Officers will be needed to assist
2 with the transition of the business of running the Hospital to VHA. Further, the Debtor will utilize
3 their knowledge and experience to (1) propose a plan of liquidation, which entails the assimilation of
4 much information regarding (i) the remaining assets of the Debtor, including charitable contributions
5 being held by the Debtor, and how to handle the disposition or distribution those assets and (ii) the
6 claims against the Debtor, (2) obtain confirmation of the plan, which will include testimony to the
7 Court that supports various legal requirements of plan confirmation, (3) review all of the claims filed
8 against the Debtor and determine what if any objections to the claims must be raised, (4) prosecute
9 any claims objections, including supplying the Court the evidence necessary to make a decision as to
10 the appropriate priority and amount of the objected to claims, and (5) make distributions to the
11 creditors holding valid, allowed claims. The Officers have the knowledge and experience necessary
12 to accomplish these tasks so that the chapter 11 case can be brought to an expeditious conclusion,
13 distributions can be made to the valid creditors and the chapter 11 case can be closed.

14 **H. Need for the Incentive Plan**

15 The demands placed upon the Officers have never been greater. In addition to responsibility
16 for the day-to-day management of the Hospital, the Officers have shouldered significant
17 responsibilities stemming from the preparation and administration of the Debtor's chapter 11 case,
18 including, but not limited to, assisting with (1) the preparation of the "First Day" motions, (2) the
19 negotiation of the DIP financing, (3) the negotiation of the sale, attending hearings and bankruptcy
20 related meetings, addressing many day to day issues that are raised by employees, vendors and
21 patients regarding the bankruptcy filing, dealing with the press, assisting VHA with requests for
22 information, responding to the requests of the California Attorney General, and complying with the
23 requirements of the ASA (some of which are discussed above). Further, as discussed above, after
24 the completion of the sale, the Officers' participation in the winding down of the Debtor's estate is
25 key. As is evident, the Debtor has relied heavily on the Officers' knowledge, experience and
26 dedication and will continue to do so for some time. The implementation of the proposed Incentive
27 Plan is necessary and appropriate to compensate the Officers adequately for the discharge of very
28 significant restructuring responsibilities they have assumed in addition to their day-to-day duties and

1 to incentivize the Officers to continue devoting their energy, knowledge, expertise and creativity to
2 the Debtor's efforts to conclude this chapter 11 case as expeditiously as possible.

3 **I. The Incentive Plan**

4 The Incentive Plan is a performance bonus plan that is designed to incentivize the two key
5 officers of the Debtor who will have the most important role in maximizing value for the Debtor's
6 chapter 11 estate for its creditors by using their skills, knowledge, and experience. The bonuses are
7 designed to motivate and are paid for performance only. The total bonuses to be paid under the
8 Incentive Plan would be \$0 if none of the milestones are achieved; however, if all the milestones are
9 achieved, the bonus amount would be only \$286,000. The milestones are goals that would garner
10 the highest expected value for the estate and the creditors in the least amount of time.

11 The specific milestones in the Incentive Plan are (1) the closing of the sale of the Hospital,
12 (2) the filing of a liquidating plan by not later than one month after the closing of the sale of the
13 Hospital, (3) the confirmation of the liquidating plan within two months after the plan is filed, and
14 (4) having the claims review process completed and all objections to claims filed by no later than
15 two months after the liquidating plan is confirmed by the Bankruptcy Court. Each of the Officers
16 will earn a bonus equal to one-eighth of her/his annual salary upon the successful completion of each
17 applicable milestone (one-fourth of the total possible bonus amount) and the bonus will be paid once
18 each of the Officers reaches the end of her/his respective employment period, unless the Officer is
19 terminated by the Debtor for cause, in which case all Incentive Plan bonuses earned by that Officer
20 will become unearned.

21 **IV.**

22 **ARGUMENT**

23 **A. There Is a Sound Business Purpose for the Implementation of the Incentive Plan**
24 **Pursuant to Section 363(b) of the Bankruptcy Code**

25 The Court may authorize the Debtor to implement the Incentive Plan under section 363(b)(1)
26 of the Bankruptcy Code. Section 363(b)(1) provides that "[t]he trustee, after notice and a hearing,
27 may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11
28 U.S.C. § 363(b)(1). The use, sale, or lease of property of the estate, other than in the ordinary course

1 of business, is authorized when a “sound business purpose” justifies such action. *See, e.g., Myers v.*
2 *Martin (In re Martin)*, 91 F.3d 389, 395 (3d Cir. 1996) (noting that under normal circumstances,
3 courts defer to a trustee’s judgment concerning use of property under section 363(b) when there is a
4 legitimate business justification); *Walter v. Sunwest Bank (In re Walter)*, 83 B.R. 14, 17 (9th Cir.
5 B.A.P. 1988) (“The bankruptcy court has considerable discretion in deciding whether to approve or
6 disapprove the use of estate property by a debtor in possession in the light of sound business
7 justification.”) *citing In re Lionel Corp.*, 722 F. 2nd 1063, 1066 (2nd Cir. 1983) and *In re Continental*
8 *Air Lines, Inc.*, 780 F. 2nd 1223 (5th Cir. 1986); *In re Ernst Home Center, Inc.*, 209 B.R. 974, 979
9 (Bankr. W.D. Wa. 1997) (transaction out of the ordinary course of business must be based on the
10 debtor’s reasonable business judgment).

11 Historically, courts have approved employee compensation programs that are outside of the
12 ordinary course of business pursuant to section 363(b) of the Bankruptcy Code. *See, e.g., Dai-Ichi*
13 *Kangyo Bank Ltd. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.*,
14 242 B.R. 147, 153 (D. Del. 1999) (affirming bankruptcy court approval of key employee retention
15 program; stating that “in determining whether to authorize the use, sale, or lease of property of the
16 estate under [section 363(b)], courts require the debtors to show that a sound business purpose
17 justifies such actions”); *In re Global Home Products, LLC*, 369 B.R. 778, 784 (Bankr. D. Del. 2007)
18 (“The reasonable use of incentives and performance bonuses are considered the proper exercise of a
19 debtor’s business judgment.”); *In re Nobex Corp.*, 2006 Bankr. LEXIS 417, 2006 WL 4063024, at
20 *2 (Bankr. D. Del. Jan. 19, 2006) (approving incentive pay outside of ordinary course where it was
21 “an appropriate exercise of the Debtor’s business judgment”); *In re America West Airlines, Inc.*, 171
22 B.R. 674, 678 (Bankr. D. Ariz. 1994) (it is the proper use of a debtors’ business judgment to propose
23 bonuses for employees who helped propel the debtor successfully through the bankruptcy process);
24 *In re Interco Inc.*, 128 B.R. 229, 234 (Bankr. E.D. Mo. 1991) (“debtors’ business judgment” was
25 controlling in the approval of a performance/retention program).

26 The Debtor submits that there is a sound business purpose for the implementation of the
27 Incentive Plan. As noted above, the Debtor must accomplish a significant amount of work in a
28 relative short period of time in order to maximize creditor outcomes and ensure distributions to

1 creditors as expeditiously as possible. This work is in addition to the Officers' day-to-day duties of
2 operating the Hospital and a significant amount of the work is of a different nature than the work the
3 Officers were originally employed to perform. Much of this work will need to be completed after
4 most of the employees of the Debtor have become employees of VHA, the purchaser. The Debtor
5 believes that the Officers, working without assistance of other employees after the completion of the
6 sale and based upon their institutional knowledge and experience, will be able to effectively and
7 expeditiously perform these tasks. To help ensure that this happens, the Debtor formulated the
8 Incentive Plan. The Debtor believes that the Incentive Plan provides a mechanism by which the
9 Officers, whose institutional knowledge and expertise will be of great benefit to the Debtor and its
10 creditors during the completion of the chapter 11 case, will be motivated to work to complete the
11 requisite work necessary to close the sale of the Hospital, propose and confirm a liquidating plan,
12 review claims, and file objections to claims as necessary, all as expeditiously as possible and at a
13 reasonable cost to the Debtor's estate. Moreover, the Officers will only be paid a performance bonus
14 if they meet the objective milestones set forth in the Incentive Plan. Further, the Debtor's Board of
15 Directors reviewed, considered and approved the Incentive Plan.

16 The Debtor submits that implementation of the Incentive Plan is an appropriate exercise of its
17 business judgment under section 363(b)(1) of the Bankruptcy Code and should therefore be
18 approved by the Court.

19 **B. The Incentive Plan Complies With Section 503(c) of the Bankruptcy Code**

20 Section 503(c) of the Bankruptcy Code is applicable to all bankruptcy cases filed after
21 October 2005. It provides criteria for courts to use in approving certain types of payments to
22 insiders. Section 503(c) contains: (1) limitations on retention plans for insiders of a debtor, (2)
23 limitations on severance payments to insiders of a debtor, and (3) standards governing other transfers
24 or obligations that are outside the ordinary course of business and not justified by the facts and
25 circumstances of the case, including transfers made to, or obligations incurred for the benefit of,
26 officers, managers, or consultants hired after the date of the filing of the Petition. 11 U.S.C. §
27 503(c). For the reasons set forth herein, neither subsection 503(c)(1) nor 503(c)(2) are applicable to
28 the Incentive Plan. Moreover, as set forth below, the Incentive Plan is justified under the facts of

1 this case and, therefore, complies with subsection 503(c)(3) of the Bankruptcy Code and should be
2 approved.

3 Pursuant to the statute's plain language, subsection 503(c)(1) of the Bankruptcy Code
4 pertains solely to retention plans,⁴ and section 503(c)(2) only addresses the requirements for
5 severance plans.⁵ Neither section applies to performance-based incentive plans. *See, e.g., Global*
6 *Home Products*, 369 B.R. at 783 ("If [the proposed plans] are plans to incentivize management, the
7 analysis utilizes the more liberal business judgment review under § 363."); *In re Calpine Corp.*, Case
8 No. 05-60200, 04/26/2006 Hearing Tr. at 84-87 [Docket No. 1900] (Bankr. S.D.N.Y. 2006); *In re*
9 *Nellson Nutraceutical, Inc.*, 369 B.R. 787, 802 (Bankr. D. Del. 2007) ("Under the facts of this case,
10 although the modification of the 2006 bonus program has some retentive effect, it is for the primary
11 purpose of motivating employees and, thus, the limitations of section 503(c)(1) are not applicable.").
12 Indeed, Judge Lifland, in *Dana*, held that:

13
14 If sections 503(c)(1) and (c)(2) are not operative, a court may consider
15 whether the payments are permissible under section 503(c)(3), which
16 limits payments made to management and employees, among other
17 things, outside of the ordinary course, unless such payments are shown
18 to be justified under the facts and circumstances of the chapter 11 case.
19 As one treatise points out, the test appears to be no more stringent a
20 test than the one courts must apply in approving any administrative
21 expense under section 503(b)(1)(A).

22 *In re Dana Corp.*, 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006).

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26 ⁴ 11 U.S.C. § 503(c)(1) ("Notwithstanding subsection (b), there shall neither be allowed, nor paid – a transfer made to, or
an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with
the debtor's business, absent a finding by the court based on evidence in the record that – (A) the transfer or obligation is
essential to retention of the person because the individual has a bona fide job offer from another business at the same or
greater rate of compensation; (B) the services provided by the person are essential to the survival of the business; and (C)
either – (i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an
amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement
employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or (ii) if
no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees
during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of
the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during
the calendar year before the year in which such transfer is made or obligation is incurred....").

27
28 ⁵ 11 U.S.C. § 503(c)(2) ("Notwithstanding subsection (b), there shall neither be allowed, nor paid – (2) a severance
payment to an insider of the debtor, unless – (A) the payment is part of a program that is generally applicable to all full-
time employees; and (B) the amount of the payment is not greater than 10 times the amount of the mean severance pay
given to non-management employees during the calendar year in which the payment is made....")

1 The Incentive Plan is neither a retention plan nor a severance plan. Instead, the Incentive
2 Plan is a performance-based plan that provides for targeted payments to the Officers if they meet the
3 objective performance criteria set forth in the Incentive Plan. The purpose of the Incentive Plan is to
4 motivate the Officers to work very hard and fast in order to obtain the performance bonuses. Neither
5 the performance goals nor the payments provided under the Incentive Plan have an impermissible
6 retention or severance component. Therefore, subsections 503(c)(1) and (c)(2) are not applicable to
7 the Incentive Plan.

8 The Incentive Plan, and the payments contemplated there under, comply with section
9 503(c)(3) of the Bankruptcy Code. The statute states that:

10 Notwithstanding subsection (b), there shall neither be allowed, nor
11 paid—... (3) other transfers or obligations that are outside of the
12 ordinary course of business and not justified by the facts and
13 circumstances of the case, including transfers made to, or obligations
14 incurred for the benefit of, officers, managers, or consultants hired
15 after the date of the filing of the petition.

16 11 U.S.C. § 503(c)(3). Courts analyzing various payments under section 503(c)(3) have held that
17 they must use the “business judgment” standard as the proper standard for determining whether
18 incentive programs and payments thereunder are justified. *See e.g., Global Home Products*, 369 B.R.
19 at 783.

20 In *Dana*, Judge Lifland stated that management incentive programs should be evaluated
21 under the business judgment standard, which requires a debtor to satisfy the Court’s inquiry into
22 factors such as:

- 23 (1) Is there a reasonable relationship between the plan proposed and the
24 results to be obtained, *i.e.* will the key employee stay for as long as it
25 takes for the debtor to reorganize or market its assets, or in the case of
26 a performance incentive, is the plan calculated to achieve the desired
27 performance?
- 28 (2) Is the cost of the plan reasonable in the context of the debtors’ assets,
liabilities and earning potential?

- 1 (3) Is the scope of the plan fair and reasonable; does it apply to
- 2 employees; does it discriminate unfairly?
- 3 (4) Is the plan or proposal consistent with industry standards?
- 4
- 5 (5) What were the due diligence efforts of the debtor in investigating the
- 6 need for a plan; analyzing which key employees need to be
- 7 incentivized; what is available; what is generally applicable in a
- 8 particular industry?
- 9 (6) Did the debtor receive independent counsel in performing due
- 10 diligence and in creating and authorizing the incentive compensation?

11 *Dana Corp.*, 358 B.R. at 576-77. Moreover, Judge Lifland noted that courts generally take a
12 “holistic” view of and measure of compensation packages. *Id.* at 571.

13 As noted above, the Debtor has a sound business purpose for establishing the Incentive Plan,
14 and the Incentive Plan satisfies the applicable factors articulated by Judge Lifland in *Dana*.

15 First, the Incentive Plan is a performance-based plan that has been calibrated by the Debtor to
16 motivate the Officers to “achieve the desired performance” under the Incentive Plan. The Officers
17 will earn a bonus only upon the completion of the stated milestones, all of which are essential to a
18 successful chapter 11 case wherein the Hospital is sold for the best price obtainable at auction and its
19 operations are maintained for the benefit of the community it serves and the creditors’ claims are
20 resolved and paid in an expeditious manner through a confirmed liquidating plan.

21 Second, the Debtor believes that the cost of the Incentive Plan is reasonable in the context of
22 the chapter 11 case and in light of the amount of work that must be completed by the Officers in a
23 compressed amount of time that is over and above their normal duties of running the business of the
24 Debtor.

25 Moreover, the bonuses, which is \$286,000 if all of the milestones are achieved, are less than
26 1% of the purchase price of the Hospital. The amount of the performance bonuses are, therefore,
27 reasonable under the circumstances of this chapter 11 case and if their payment will expedite the
28 payment of the claims of the creditors.

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1 Third, the Incentive Plan is “fair and reasonable” in its scope and does not “discriminate
2 unfairly.” The Debtor believes that the Officers have gone “above the call of duty” to see that the
3 Hospital sale is successful and will continue to be essential in that endeavor. Further, the Debtor
4 believes that the Officers, working alone after the sale is concluded, will be able to accomplish the
5 other three milestones to the benefit of all interested parties. Because the Debtor designed the
6 Incentive Plan to only include those employees whose services, in the Debtor’s opinion, are truly
7 necessary to achieving the goals of the Incentive Plan, the Debtor submits that the Incentive Plan is
8 fair and reasonable.

9 The Debtor submits that the fourth factor noted by Judge Lifland – i.e., is the plan or
10 proposal is consistent with industry standards – is not applicable to the facts and circumstances of
11 the Debtor’s case. To the best of the Debtor’s knowledge, there is no “industry standard” for key
12 employee incentive programs in chapter 11 cases of hospitals that have been sold for a sufficient
13 amount of money to pay all creditors in full. The Debtor looked for key employee incentive plans
14 that had been put in place by hospitals in chapter 11, but could find none in the Central District of
15 California. It found two such plans that had been approved for hospitals that filed chapter 11
16 petitions in the Southern District of New York, however, those hospitals were ceasing operations and
17 faced a different set of issues than the Debtor. In the Albert Lindley Lee Memorial Hospital case,
18 Case No. 09-30845, a 67-bed hospital that closed operations, the incentive plan was for seven
19 employees who were to stay and assist the Debtor in certain limited winding down tasks. The
20 incentive plan was to pay the seven employees a maximum bonus of \$127,000 for staying to do the
21 necessary tasks. In the Saint Vincents Catholic Medical Centers of New York case, Case No. 10-
22 11963, the incentive plan was for fifty-five employees and was to pay a maximum bonus of
23 \$1,500,000, which apparently was being funded by a DIP lender, for tasks related to the wind down
24 and closure of the hospital and the transfer or sale of the remaining healthcare services.

25 Fifth, the Debtor engaged in appropriate due diligence in formulating the Incentive Plan
26 under the facts and circumstances of its chapter 11 case. The Debtor’s board of directors, which is
27 composed of independent business persons from the community, approved the Incentive Plan.
28

1 Further, although the Debtor does not believe that the Incentive Plan has to be approved by
2 the purchaser of its assets, out of an abundance of caution, the Debtor requested the purchaser's
3 approval pursuant to section 4.3 of the ASA on December 17, 2010 and again on December 22,
4 2010. Section 4.3 of the ASA also provides that the Debtor is deemed to have obtained the
5 purchaser's consent if the purchaser has not given the Debtor written notice of its objections within
6 five business days after the Debtor's notice to the purchaser is given. As of the date of the filing of
7 this Motion, the Debtor has not received a response from the purchaser so the purchaser is deemed to
8 have consented to the Incentive Plan.

9 Based upon the foregoing, the Debtor submits that it has established a "sound business
10 purpose" for the formulation and implementation of the Incentive Plan, and therefore has satisfied
11 the requirements of section 363(b) and 503(c)(3) of the Bankruptcy Code. As set forth in detail
12 above, the Incentive Plan is a "true" incentive plan that has been designed to motivate the Officers to
13 produce results. The Incentive Plan is not a "pay to stay" plan; the Officers will only receive
14 payment if they meet the performance goals. Accordingly, the Debtor submits that the Incentive
15 Plan should be approved so that as the Officers achieve the milestones, they will earn a portion of
16 the bonus and will be paid the amount of the earned bonuses upon their respective terminations,
17 unless terminated by the Debtor for cause, in which case, any performance bonus the affected
18 Officer has earned will be deemed unearned and will not be paid.

19 **V.**

20 **CONCLUSION**

21 **WHEREFORE**, the Debtor respectfully requests that the Court enter an Order (i) granting
22 the Motion, (ii) approving the Incentive Plan, (iii) authorizing the Debtor to pay the Incentive Plan
23 payments as they become due, and (iv) granting such other and further relief as it deems necessary
24 and appropriate.

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Dated: January 5, 2011

PACHULSKI STANG ZIEHL & JONES LLP

By /s/ Scotta E. McFarland
Samuel R. Maizel
Scotta E. McFarland
Mary D. Lane
Attorneys for Victor Valley Community
Hospital, Debtor and Debtor in Possession

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ATTORNEYS AT LAW
LOS ANGELES, CALIFORNIA

DECLARATION OF KATHY DAVIS

I, Kathy Davis, do state and declare as follows:

1. I am the Chairperson of the Board of Directors for Victor Valley Community Hospital (the "Debtor), the chapter 11 debtor and debtor in possession in the above referenced case. Unless otherwise stated in this declaration, I have personal knowledge of the facts set forth herein. If I were called to testify as a witness in this matter, I could and would competently testify to each of the facts set forth herein. I am authorized to submit this Declaration on behalf of the Board of Directors of the Debtor.

2. This declaration is being submitted in connection with the *Notice of Motion and Motion of Debtor for Order Approving a Key Employee Incentive Plan and Authorizing Payments There Under*. Terms not otherwise defined herein shall have the meaning given them in the Motion.

3. The Debtor is governed by a Board of Directors (the "Board") that is comprised of six members who are leaders in the High Desert community: Dennis G. Killion, Vice-Chair (educator); Thomas Brown (retired bank president); Michael Fermin (Deputy District Attorney); Tim Jasper (local business owner); Herbert Williamson, III (Public Defender) and me, Chair (retired political consultant)

4. The Debtor's Chief Executive Officer is Cathy Pelley, who has served in this position since July 2009. Based upon information and belief, prior to that, she was a consultant for the Hospital for the previous four months; CEO at Glendale Memorial Hospital in Glendale, California; and CEO at St. Mary's Regional Medical Center in Apple Valley, California. She is a veteran, having served as an Army nurse during the Vietnam War. She has a Nursing Degree from Philadelphia General Hospital, a Bachelor of Science degree in Business Administration and a Master of Science degree in Organization Development, both from the University of San Francisco, and has worked in the hospital industry since approximately 1970, including more than 40 years as a CEO or equivalent position.

5. The Debtor's Chief Financial Officer and Chief Information Officer is Edward Matthews. Based upon information and belief, he has served in this position since December 2008. Prior to that, he was the founder of and served as the principal manager for Neved Investments; the

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1 Chief Financial Officer for St. Johns Regional Medical Center in Oxnard, California; a principal
2 with Healthcare Marketing Group, a healthcare industry investment banking group, and the Chief
3 Financial Officer of Doctors' Hospital of Montclair, in Montclair, California. He also served in the
4 United States Army during the Vietnam War, including service in Vietnam, and was awarded the
5 Bronze Star Medal. He has a degree in Business Administration, with a concentration in
6 Accounting, and a Masters of Business Administration, both from the University of Texas at
7 Arlington. He has worked in the hospital industry since 1975.

8 6. Pursuant to the Sale Procedures Order, the Debtor held an auction of the Assets on
9 November 5, 2010, and two qualified bidders participated in the auction. VHA was the successful
10 bidder, bidding \$37 million dollars.

11 7. The ASA contains many obligations and covenants that the Debtor must perform as
12 well as conditions that must be met by the Debtor in order for the sale of the Hospital to close. In
13 order to avoid a breach by the Debtor of the ASA, the Debtor must perform under its terms, which
14 performance includes, but are not limited to, the following: (1) furnishing VHA additional financial
15 and operating data and other information regarding businesses and properties of the Hospital; (2)
16 carrying on the business of the Hospital, maintaining the Hospital, performing all material
17 obligations under certain contracts and leases of the Hospital, and using reasonable efforts to
18 maintain the Hospital's respective business organizations and its relationships with physicians,
19 suppliers, customers and others having business relationships with the Hospital; (3) cooperating with
20 VHA in its efforts to obtain all approvals and licenses; (4) delivering to VHA monthly unaudited
21 financial statements; (5) filing all Medicare, Medi-Cal, TRICARE, Blue Cross and other termination
22 cost reports required; and (6) using reasonable efforts to obtain all governmental and regulatory
23 agency approvals necessary for the closing of the sale of the Hospital. The Officers are key to the
24 performance of each of the covenants in the ASA and, therefore, to the closing of the sale of the
25 Hospital for the benefit of all parties.

26 8. The conditions to VHA's obligation to close the sale include, but are not limited to,
27 the following: (1) the Debtor must sign and deliver all documents, instruments and certificates as
28 required by the ASA; (2) the Debtor must have performed or complied with, in all material respects,

1 all obligations, covenants, agreements, and conditions of the Debtor in the ASA; and (3) the
2 California Attorney General shall have approved the sale of the Hospital to VHA. As with the
3 covenants, because of the Officers' knowledge of the Hospital, the Attorney General's requirements
4 and the ASA, their involvement in the satisfaction of these and the other conditions to the closing of
5 the sale is essential.

6 9. After the sale of the Hospital has closed and most of the Hospital's employees have
7 become employees of VHA, the chapter 11 case will continue. In fact, it is likely that the only two
8 employees of the Debtor who will remain are the Officers. The Officers will be needed to assist
9 with the transition of the business of running the Hospital to VHA. Further, the Debtor will utilize
10 the Officers' knowledge and experience to (1) propose a plan of liquidation, which entails the
11 assimilation of much information regarding (i) the remaining assets of the Debtor, including
12 charitable contributions being held by the Debtor, and how to handle the disposition or distribution
13 those assets and (ii) the claims against the Debtor, (2) obtain confirmation of the plan, which will
14 include testimony to the Court that supports various legal requirements of plan confirmation, (3)
15 review all of the claims filed against the Debtor and determine what if any objections to the claims
16 must be raised, (4) prosecute any claims objections, including supplying the Court the evidence
17 necessary to make a decision as to the appropriate priority and amount of the objected to claims, and
18 (5) make distributions to the creditors holding valid, allowed claims. The Officers have the
19 knowledge and experience necessary to accomplish these tasks so that the chapter 11 case can be
20 brought to an expeditious conclusion, distributions can be made to the valid creditors and the chapter
21 11 case can be closed.

22 10. The demands placed upon the Officers have never been greater. In addition to
23 responsibility for the day-to-day management of the Hospital, the Officers have shouldered
24 significant responsibilities stemming from the preparation and administration of the Debtor's chapter
25 11 case, including, but not limited to, assisting with (1) the preparation of the "First Day" motions,
26 (2) the negotiation of the DIP financing, (3) the negotiation of the sale, attending hearings and
27 bankruptcy related meetings, addressing many day to day issues that are raised by employees,
28 vendors and patients regarding the bankruptcy filing, dealing with the press, assisting VHA with

1 requests for information, responding to the requests of the California Attorney General, and
2 complying with the requirements of the ASA (some of which are discussed above). Further, as
3 discussed above, after the completion of the sale, the Officers' participation in the winding down of
4 the Debtor's estate is key. As is evident, the Debtor has relied heavily on the Officers' knowledge,
5 experience and dedication and will continue to do so for some time. The implementation of the
6 proposed Incentive Plan is necessary and appropriate to compensate the Officers adequately for the
7 discharge of very significant restructuring responsibilities they have assumed in addition to their
8 day-to-day duties and to incentivize the Officers to continue devoting their energy, knowledge,
9 expertise and creativity to the Debtor's efforts to conclude this chapter 11 case as expeditiously as
10 possible.

11 11. The Incentive Plan is a performance bonus plan that is designed to incentivize the two
12 key officers of the Debtor who will have the most important role in maximizing value for the
13 Debtor's chapter 11 estate for its creditors by using their skills, knowledge, and experience. The
14 bonuses are designed to motivate and are paid for performance only. The total bonuses to be paid
15 under the Incentive Plan would be \$0 if none of the milestones are achieved; however, if all the
16 milestones are achieved, the bonus amount would be only \$286,000, less than 1% of the \$37 million
17 dollar purchase price. The milestones are goals that would garner the highest expected value for the
18 estate and the creditors in the least amount of time. The Board believes that the cost of the Incentive
19 Plan is reasonable in the context of the chapter 11 case and in light of the amount of work that must
20 be completed by the Officers in a compressed amount of time that is over and above their normal
21 duties of running the business of the Debtor.

22 12. The specific milestones in the Incentive Plan are (1) the closing of the sale of the
23 Hospital, (2) the filing of a liquidating plan by not later than one month after the closing of the sale
24 of the Hospital, (3) the confirmation of the liquidating plan within two months after the plan is filed,
25 and (4) having the claims review process completed and all objections to claims filed by no later
26 than two months after the liquidating plan is confirmed by the Bankruptcy Court. Each of the
27 Officers will earn a bonus equal to one-eighth of her/his annual salary upon the successful
28 completion of each applicable milestone (one-fourth of the total possible bonus amount) and the

1 bonus will be paid once each of the Officers reaches the end of her/his respective employment
2 period, unless the Officer is terminated by the Debtor for cause, in which case all Incentive Plan
3 bonuses earned by that Officer will become unearned.

4 13. As noted above, the Debtor must accomplish a significant amount of work in a
5 relative short period of time in order to maximize creditor outcomes and ensure distributions to
6 creditors as expeditiously as possible. This work is in addition to the Officers' day-to-day duties of
7 operating the Hospital and a significant amount of the work is of a different nature than the work the
8 Officers were originally employed to perform. Much of this work will need to be completed after
9 most of the employees of the Debtor have become employees of VHA, the purchaser. The Board
10 believes that the Officers, working without assistance of other employees after the completion of the
11 sale and based upon their institutional knowledge and experience, will be able to effectively and
12 expeditiously perform these tasks. To help ensure that this happens, the Debtor formulated the
13 Incentive Plan. The Board believes that the Incentive Plan provides a mechanism by which the
14 Officers, whose institutional knowledge and expertise will be of great benefit to the Debtor and its
15 creditors during the completion of the chapter 11 case, will be motivated to work to complete the
16 requisite work necessary to close the sale of the Hospital, propose and confirm a liquidating plan,
17 review claims, and file objections to claims as necessary, all as expeditiously as possible and at a
18 reasonable cost to the Debtor's estate. Moreover, the Officers will only be paid a performance bonus
19 if they meet the objective milestones set forth in the Incentive Plan.

20 14. The Board believes that the Officers have gone "above the call of duty" to see that the
21 Hospital sale is successful and will continue to be essential in that endeavor. Further, the Board
22 believes that the Officers, working alone after the sale is concluded, will be able to accomplish the
23 other three milestones to the benefit of all interested parties. Because the Debtor designed the
24 Incentive Plan to only include those employees whose services, in the Board's opinion, are truly
25 necessary to achieving the goals of the Incentive Plan, the Board believes that the Incentive Plan is
26 fair and reasonable.

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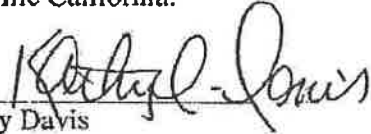
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1 15. The Debtor sought the advise of the Board regarding the terms of the Incentive Plan,
2 the members of which will not receive any payments under the Incentive Plan. Moreover, the Board
3 has unanimously approved the Incentive Plan.

4 16. Based upon the foregoing, I submit that the implementation of the Incentive Plan is
5 an appropriate exercise of the Board's business judgment and should therefore be approved by the
6 Court.

7 I declare under penalty of perjury under the laws of the United States of America that the
8 foregoing is true and correct.

9 Executed this 5 day of January, 2011 at Victorville California.

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Kathy Davis

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DECLARATION OF SCOTTA E. McFARLAND

I, Scotta E. McFarland, do state and declare as follows:

1. I am an attorney at law duly licensed to practice in the state of California. I am of counsel with the law firm of Pachulski Stang Ziehl & Jones LLP, counsel of record for Victor Valley Community Hospital (the “Debtor”), the debtor and debtor in possession in the above-captioned chapter 11 case.

2. Except as otherwise stated, I have personal knowledge of the facts set forth herein and if called as a witness I could and would competently testify thereto.

3. I submit this declaration in support of the *Motion of Debtor for Order Approving a Key Employee Incentive Plan and Authorizing Payments There Under*. Terms not otherwise defined herein shall have the meaning given them in the Motion.

4. Although the Debtor does not believe that the Incentive Plan has to be approved by the purchaser of its assets, out of an abundance of caution, I sent emails on behalf of the Debtor to counsel for the purchaser requesting the purchaser’s approval of the Incentive Plan pursuant to section 4.3 of the ASA on December 17, 2010 and again on December 22, 2010. Section 4.3 of the ASA also provides that the Debtor is deemed to have obtained the purchaser’s consent if the purchaser has not given the Debtor written notice of its objections within five business days after the Debtor’s notice to the purchaser is given. As of the date of the filing of this Motion, the Debtor has not received a response from the purchaser so the purchaser is deemed to have consented to the Incentive Plan.

5. The fourth factor noted by Judge Lifland in *In re Dana Corp.*, 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006) to be considered by courts in determining whether to approve incentive plans such as the one proposed in the Motion – *i.e.*, is the plan or proposal is consistent with industry standards – is not applicable to the facts and circumstances of the Debtor’s case. To the best of the my knowledge, there is no “industry standard” for key employee incentive programs in chapter 11 cases of hospitals that have been sold for a sufficient amount of money to pay all creditors in full. We looked for key employee incentive plans that had been put in place by hospitals in chapter 11,

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1 but could find none in the Central District of California. We found two such plans that had been
2 approved for hospitals that filed chapter 11 petitions in the Southern District of New York, however,
3 those hospitals were ceasing operations and faced a different set of issues than the Debtor. In the
4 Albert Lindley Lee Memorial Hospital case, Case No. 09-30845, a 67-bed hospital that closed
5 operations, the incentive plan was for seven employees who were to stay and assist the Debtor in
6 certain limited winding down tasks. The incentive plan was to pay the seven employees a maximum
7 bonus of \$127,000 for staying to do the necessary tasks. In the Saint Vincents Catholic Medical
8 Centers of New York case, Case No. 10-11963, the incentive plan was for fifty-five employees and
9 was to pay a maximum bonus of \$1,500,000, which apparently was being funded by a DIP lender,
10 for tasks related to the wind down and closure of the hospital and the transfer or sale of the
11 remaining healthcare services.

12 I declare under penalty of perjury under the laws of the United States of America that the
13 foregoing is true and correct.

14 Executed this 5th day of January, 2011 at Los Angeles, California.

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16 /s/ Scotta E. McFarland
17 Scotta E. McFarland
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NOTE: When using this form to indicate service of a proposed order, do not list any person or entity in Category I.
Proposed orders do not generate an NEF because only orders that have been entered are placed on the CM/ECF docket.

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is:
10100 Santa Monica Boulevard, 11th Floor, Los Angeles, CA 90067

A true and correct copy of the foregoing document **NOTICE OF MOTION AND MOTION OF DEBTOR FOR ORDER APPROVING A KEY EMPLOYEE INCENTIVE PLAN AND AUTHORIZING PAYMENTS THERE UNDER; MEMORANDUM OF POINTS AND AUTHORITIES; AND DECLARATIONS OF KATHY DAVIS AND SCOTTA E. MCFARLAND IN SUPPORT THEREOF** will be served or was served (a) on the judge in chambers in the form and manner required by LBR 5005-2(d); and (b) in the manner indicated below:

I. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING ("NEF") – Pursuant to controlling General Order(s) and Local Bankruptcy Rule(s) ("LBR"), the foregoing document will be served by the court via NEF and hyperlink to the document. On **January 5, 2011** I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following person(s) are on the Electronic Mail Notice List to receive NEF transmission at the email address(es) indicated below:

Service information continued on attached page

II. SERVED BY U.S. MAIL OR OVERNIGHT MAIL (indicate method for each person or entity served):

On **January 5, 2011** I served the following person(s) and/or entity(ies) at the last known address(es) in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States Mail, first class, postage prepaid, and/or with an overnight mail service addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

By Overnight Mail

Honorable Catherine Bauer
United States Bankruptcy Court
Central District of California
3420 Twelfth Street, Suite 365
Riverside, CA 92501-3819

Service information continued on attached page

III. SERVED BY PERSONAL DELIVERY, FACSIMILE TRANSMISSION OR EMAIL (indicate method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on **January 5, 2011** I served the following person(s) and/or entity(ies) by personal delivery, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on the judge will be completed no later than 24 hours after the document is filed.

Service information continued on attached page

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

January 5, 2011

Date

Myra Kulick

Type Name

/s/ Myra Kulick

Signature

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Case 8:12-bk-12896-CB Doc 465 Filed 01/05/11 Entered 01/05/11 18:49:27 Desc
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II. SERVED BY U.S. MAIL OR OVERNIGHT MAIL
See attached service lists

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Chapter 11 Case No.: 6:10-bk-39537-CB
2002 Service List**

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Chair, Governing Board of Directors
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Representative: Steve Carlson

Committee Member

PHS Professional Hospital Supply
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Temecula, CA 92590
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Rodney W. Brown, J.D.
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Sacramento, CA 95814

California Health Facilities Financing Authority
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Commercial Litigation Branch
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Attention: William E. Thomas, Esq.

Victor Valley Hospital Acquisition, Inc.
6800 Indiana Avenue, Suite 130
Riverside, CA 92506
Attention: William E. Thomas, Esq.

Tin Kin Lee on behalf of Creditor Inland Empire Health Plan
Tin Kin Lee Law Offices
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Pasadena, CA 91101

Liquidity Solutions Inc
One University Plaza
Ste 312
Hackensack, NJ 07601

Tannor Partners Credit Fund II, LP
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Armonk, NY 10504

Exhibit "E3"

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

THE ALBERT LINDLEY LEE MEMORIAL HOSPITAL
a/k/a A.L. LEE MEMORIAL HOSPITAL,

Case No. 09-30845
Chapter 11 Case

Debtor.

ORDER APPROVING KEY EMPLOYEE INCENTIVE PLAN

Debtor The Albert Lindley Lee Memorial Hospital, a/k/a A.L. Lee Memorial Hospital (the "Debtor"), having moved this Court for an Order, pursuant to 11 U.S.C. §§ 105, 363(b) and 503, authorizing and approving the implementation of a program which will provide certain employees with incentive payments to continue maximizing the value of the Debtor's assets and providing for the orderly liquidation of the Debtor's estate for the benefit of its creditors;

NOW, upon reading and filing the Affidavit in Support of Application for Order Reducing Time for Hearing to Consider Debtor's Motion for Order Approving Key Employee Incentive Plan sworn to the 4th day of June, 2009, the Order Reducing Time for Notice of Hearing to Consider Debtor's Motion for Order Approving Key Employee Incentive Plan dated June 4, 2009, the Notice of Motion by Debtor for Order Approving Key Employee Incentive Plan dated June 4, 2009 and the Motion by Debtor for Order Approving Key Employee Incentive Plan dated June 4, 2009 (the "Motion") in support of the relief requested; and upon reading and filing the Affidavit in Response to Motion by Debtor Approving Key Employee Incentive Plan sworn to by Lee E. Woodard, Esq. on the 8th day of June, 2009 on behalf of Fulton Savings Bank; and a hearing concerning the Motion having been held by the Court on June 8, 2009 in

Syracuse, New York; and the Debtor having appeared by Bond, Schoeneck & King, PLLC (Stephen A. Donato, Esq., of counsel) in support of the relief requested; and appearances having been entered on behalf of the Official Committee of Unsecured Creditors by Arent Fox LLP (Robert M. Hirsh, Esq., of counsel), Fulton Savings Bank by Harris Beach PLLC (Lee E. Woodard, Esq., of counsel) and the Office of the United States Trustee by Guy A. Van Baalen, Esq.; and upon due deliberation of the Court and good cause appearing therefor, it is hereby

ORDERED, that the Motion is granted in its entirety; and it is further

ORDERED, that the Incentive Plan proposed by the Debtor, as more fully described in the Motion, is hereby approved in its entirety; and it is further

ORDERED, that the employees identified in the corrected Exhibit "A" attached hereto are eligible to participate in the Incentive Plan; and it is further

ORDERED, that this Court shall retain jurisdiction with respect to any and all matters related to, or arising from, the implementation of this Order.

Dated: June 8, 2009
Syracuse, New York


Hon. Margaret Cangilos-Ruiz
United States Bankruptcy Judge

EXHIBIT A

Essential Employees

<u>Employee</u>	<u>Title</u>	<u>Proposed Termination Date</u>
Dennis Casey	Executive Director	December 31, 2009
Shirley Seabury	Assistant Director/Operating Officer	August 28, 2009
Louise Sperati	Administrative Assistant	December 31, 2009
Krista Fox	Human Resources Manager	July 31, 2009
Kim Rossiter	Accounting Supervisor	July 31, 2009
Kathy Harris	Equipment/inventory specialist	August 28, 2009
Helen Flora	Accounts receivable/accounts payable	December 31, 2009

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

THE ALBERT LINDLEY LEE MEMORIAL HOSPITAL
a/k/a A.L. LEE MEMORIAL HOSPITAL,

Debtor.

Case No. 09-30845
Chapter 11 Case

CLERK OF THE
BANKRUPTCY COURT
N.D. OF NY
SYRACUSE

2009 JUN -8 PM 2:43

FILED

ORDER APPROVING KEY EMPLOYEE INCENTIVE PLAN

Debtor The Albert Lindley Lee Memorial Hospital, a/k/a A.L. Lee Memorial Hospital (the "Debtor"), having moved this Court for an Order, pursuant to 11 U.S.C. §§ 105, 363(b) and 503, authorizing and approving the implementation of a program which will provide certain employees with incentive payments to continue maximizing the value of the Debtor's assets and providing for the orderly liquidation of the Debtor's estate for the benefit of its creditors;

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Syracuse, New York; and the Debtor having appeared by Bond, Schoeneck & King, PLLC (Stephen A. Donato, Esq., of counsel) in support of the relief requested; and appearances having been entered on behalf of the Official Committee of Unsecured Creditors by Arent Fox LLP (Robert M. Hirsh, Esq., of counsel), Fulton Savings Bank by Harris Beach PLLC (Lee E. Woodard, Esq., of counsel) and the Office of the United States Trustee by Guy A. Van Baalen, Esq.; and upon due deliberation of the Court and good cause appearing therefor, it is hereby

ORDERED, that the Motion is granted in its entirety; and it is further

ORDERED, that the Incentive Plan proposed by the Debtor, as more fully described in the Motion, is hereby approved in its entirety; and it is further

ORDERED, that the employees identified in the corrected Exhibit "A" attached hereto are eligible to participate in the Incentive Plan; and it is further

ORDERED, that this Court shall retain jurisdiction with respect to any and all matters related to, or arising from, the implementation of this Order.

Dated: June 8, 2009
Syracuse, New York



Hon. Margaret Cangilos-Ruiz
United States Bankruptcy Judge

EXHIBIT A

Essential Employees

<u>Employee</u>	<u>Title</u>	<u>Proposed Termination Date</u>
Dennis Casey	Executive Director	December 31, 2009
Shirley Seabury	Assistant Director/Operating Officer	August 28, 2009
Louise Sperati	Administrative Assistant	December 31, 2009
Krista Fox	Human Resources Manager	July 31, 2009
Kim Rossiter	Accounting Supervisor	July 31, 2009
Kathy Harris	Equipment/inventory specialist	August 28, 2009
Helen Flora	Accounts receivable/accounts payable	December 31, 2009

Exhibit "E4"

Hearing Date: June 8, 2009
Time: 1:30 p.m.
Objection Deadline: 12:00 p.m., June 8, 2009
Hearing Location: Syracuse, New York

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

THE ALBERT LINDLEY LEE MEMORIAL HOSPITAL
a/k/a A.L. LEE MEMORIAL HOSPITAL,

Case No. 09-30845
Chapter 11 Case

Debtor.

**MOTION BY DEBTOR FOR ORDER
APPROVING KEY EMPLOYEE INCENTIVE PLAN**

Debtor The Albert Lindley Lee Memorial Hospital, a/k/a A.L. Lee Memorial Hospital, the debtor and debtor in possession in the above-captioned chapter 11 case (the "Debtor"), by and through its counsel, Bond, Schoeneck & King, PLLC, respectfully sets forth as follows:

1. On April 3, 2009 (the "Petition Date"), the Debtor filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code, §§ 101, *et seq.*, as amended, (the "Bankruptcy Code") with the United States Bankruptcy Court for the Northern District of New York (the "Court"). The Debtor continues to manage its assets as a debtor in possession pursuant to §§ 1107(a) and 1108 of the Bankruptcy Code.

2. On April 14, 2009, the Office of the United States Trustee appointed an Official Committee of Unsecured Creditors (the "Committee") pursuant to § 1102(a) of the Bankruptcy Code in this case. No trustee or examiner has been appointed.

3. This Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

4. The bases for the relief requested herein are §§ 105, 363(b) and 503 of the Bankruptcy Code.

BACKGROUND

5. The Debtor is a New York not-for-profit corporation located at 510 South Fourth Street, Fulton, New York. The Debtor was dedicated on May 12, 1910 as the Albert Lindley Lee Hospital, a general city hospital created under Charter of the City of Fulton. In March of 1974, the Debtor became The Albert Lindley Lee Memorial Hospital, a voluntary not-for-profit corporation organized under Section 402 of the New York State Not-for-Profit Corporation Law.

6. The Debtor operated an acute care, general hospital and was the sole provider of essential hospital services in Fulton, New York until April 26, 2009. The Debtor's primary service area was the approximately 40,000 residents in and around the City of Fulton. In addition, since 1988, the Debtor also operated the Phoenix Primary Care Center at 7 Bridge Street in Phoenix, New York, and formerly operated a Primary Care Center at 450 Fulton Street, in Hannibal, New York.

7. On November 28, 2006, the Berger Commission released a report and recommendations regarding the status of hospitals and other health care providers in New York State (the "Berger Commission Report"). The Berger Commission Report recommended that the Debtor close all of its 67 beds by June 30, 2008 and further recommended that the Debtor convert to an outpatient/urgent care center with Article 28 diagnostic and treatment center licensure.

8. During the next two years, the Debtor pursued numerous options seeking to remain open as an acute care hospital facility. During early 2008, as part of continuing negotiations, the New York State Department of Health (the "DOH") extended the Debtor's closure date until June 30, 2009 in order to provide the Debtor with additional time to pursue a potential affiliation. Despite these efforts, the Debtor was unable to repeal the Berger Commission closure recommendations and also was unable to finalize an agreement to merge with another healthcare facility.

9. During late 2008, the Debtor prepared and submitted to the DOH an application for a Certificate of Need pursuant to which the Debtor would implement the Berger Commission recommendations and operate a stand-alone urgent care/diagnostic and treatment center. Following the submission of that application, the Debtor, DOH and Oswego Health, Inc., the parent corporation of Oswego Hospital located in Oswego, New York ("Oswego Hospital"), convened a series of meetings pursuant to which it was decided that Oswego Hospital would operate the urgent care facility in Fulton, New York, and that the Debtor would cease providing acute care services and close all of its 67 beds by April 26, 2009. This decision is supported by the Debtor's and Oswego Hospital's respective Boards of Directors, whose chief concern is the preservation of access to healthcare services in Southern Oswego County.

10. On the Petition Date, the Debtor employed approximately 319 individuals. The Debtor has laid off the vast majority of its employees since it closed its hospital operations on April 26, 2009, and as of June 7, 2009, seven (7) employees will remain. The employees who remain (the "Essential Employees") are essential to preserving, assembling and liquidating the Debtor's assets in order to maximize their value for the benefit of creditors in this case. The Essential Employees also have endured the very difficult process of remaining employed while

New York State, through the Berger Commission, has directed the closure of the Debtor. The other employees previously laid off by the Debtor were eligible to collect unemployment insurance benefits from the State of New York.

11. In New York State, there are currently three (3) stages of unemployment benefits: (i) regular (26 weeks), (ii) emergency (an additional 33 weeks) and, due to legislation signed by Governor Patterson on May 20, 2009, (iii) extended (an additional 13 weeks). In accordance with the terms of the economic stimulus packages recently approved by the federal and state governments, in order to be eligible to receive the additional 46 weeks of benefits (the "Supplemental Benefit"), an individual must exhaust the regular 26 weeks of unemployment benefits by the week ending December 20, 2009. In order to be eligible for the Supplemental Benefit, therefore, an individual must commence receiving unemployment insurance benefits during the week ending June 27, 2009.¹

The Proposed Incentive Plan

12. The Debtor estimates that it will take until August 28, 2009 to close the sale of certain of its real property and tangible assets to Oswego Hospital, arrange for the sale or other disposition of its remaining equipment and account receivable assets², assist the Pension Benefit Guaranty Corporation with the termination of the Debtor's defined benefit pension plan, conclude the cost report and audit process with the Debtor's accountants, to ensure the payment of all Medicare and Medicaid reimbursements, arrange for the transfer and storage of the Debtor's business records and generally wind down a substantial portion of the Debtor's financial affairs.

¹ A one week waiting period that must occur following the termination of employment before an individual may begin receiving unemployment insurance benefits.

² The Debtor anticipates that it will seek Court approval in the near future to retain an outside firm to assist with the collection of certain accounts receivable.

13. In order to maximize the anticipated dividend to unsecured creditors, it is absolutely essential that the Debtor continue to utilize the critical institutional knowledge held by each of the Essential Employees. All of the Essential Employees have been employed by the Debtor for many years, and as such, they each possess historical and operational knowledge which will enable the Debtor to efficiently, and cost-effectively, administer its estate. Accordingly, the Debtor seeks approval to implement a program (the "Incentive Plan") which will provide the Essential Employees with certain incentive payments, and which will allow the Debtor to satisfy its duties to maximize the value of its estate³.

14. The Essential Employees, their respective job descriptions and proposed termination dates, are identified in Exhibit "A" hereto. Two (2) of the Essential Employees will separate from the Debtor on July 31, 2009, two (2) more will separate on August 28, 2009 and three (3) will remain until December 31, 2009. The Essential Employees remaining until December 31, 2009 will continue employment on a *per diem* basis in order to assist with the final administration and closure of the Debtor's chapter 11 case. The Debtor, in the exercise of its business judgment, reserves the right to lay off any Essential Employee prior to his or her proposed termination date in the event that the Employee has completed all assigned work. This will allow the Debtor to minimize its payroll costs.

15. An Essential Employee who agrees to assist the Debtor in timely satisfying its duties related to the wind-down of its financial affairs, however, would forfeit his/her eligibility for the Supplemental Benefit. Under the Incentive Plan, each Essential Employee who assists the Debtor in timely concluding the tasks discussed above and winding down the Debtor's affairs would be paid an amount (collectively, the "Incentive Payments") equal to the amount of the

³ The Debtor notes that the Incentive Plan has been reviewed and approved by the president of the Debtor's Board of Trustees.

Supplemental Benefit forfeited by that Essential Employee. The Incentive Payments aggregate \$127,000.00 and would be in addition to the regular salaries and other compensation due the Essential Employees.

16. Each Essential Employee will be paid in cash and receive 50% of his/her Incentive Payment on the last date of employment, and will receive the remaining 50% following the expiration of 26 weeks of unemployment benefits, if that Employee has not obtained other employment. The aggregate amount of the Incentive Payments would be held in escrow by Debtor's counsel and will be disbursed to the Essential Employees on the appropriate dates. The Incentive Payments are performance-related bonuses payable to the Essential Employees which will allow the Debtor to benefit from their collective institutional knowledge of the Debtor's assets and financial affairs. Each Essential Employee must be in good standing with the Debtor on his or her departure date in order to receive the first 50% installment of the Incentive Payments.

17. By this motion, the Debtor respectfully requests that the Court enter an Order pursuant to §§ 105, 363(b) and 503 of the Bankruptcy Code authorizing and approving the Incentive Plan.

DISCUSSION

A. The Incentive Plan is Appropriate Under Section 363(b) of the Bankruptcy Code

18. Section 363(b) of the Bankruptcy Code permits a debtor to use property of the estate outside the ordinary course of its business when the use of such property represents an exercise of the debtor's sound business judgment. *See e.g., In re Martin*, 91 F.3d 389, 395 (3d Cir. 1996), *citing, Fulton State Bank v. Schipper (In re Schipper)*, 933 F.2d 513, 515 (7th Cir.

1991); *In re Interco, Inc.*, 128 B.R. 229, 234 (Bankr. E.D. Mo. 1991) (“debtors’ business judgment” was controlling in the approval of a “performance/retention program”).

19. The Debtor, in its sound business judgment, has determined that the approval and implementation of the Incentive Plan will accomplish a sound business purpose by assisting the Debtor in maximizing the value of its assets and properly winding down its estate for the benefit of its creditors. The Debtor has determined that the Incentive Payments are appropriate to properly compensate, incentivize and motivate the Essential Employees to maximize the outcome for creditors in this case. Moreover, the level of compensation proposed to be paid pursuant to the Incentive Plan is appropriate and reasonable in light of the facts and circumstances and the likely benefits. Finally, the Incentive Payments will not be made to the Essential Employees until they separate from the Debtor’s employ and, in the case of the second installment payment, will not be made at all if the Essential Employee has obtained other employment prior to the expiration of his/her 26 weeks of regular unemployment insurance benefits. Any funds not distributed to the Essential Employees will be returned to the estate.

**B. The Incentive Plan is Appropriate
Under § 503 of the Bankruptcy Code**

20. The Incentive Plan also complies with § 503(c) of the Bankruptcy Code. The Incentive Plan consists of strictly performance-based payments and as such, only § 503(c)(3) applies to the Plan. *See e.g., In re Global Home Products, LLC*, 369 B.R. 778, 785-86 (only section 503(c)(3) applies where “the Plans are primarily incentivizing and only coincidentally retentive”); *In re Nellson Nutraceutical, Inc.*, 369 B.R. 787, 802 (Bankr. D. Del. 2007) (“[B]y presenting an executive compensation package that properly motivates senior management to produce and increase the value of the estate, the debtor has established that section 503(c)(1)

does not apply”), *quoting, In re Dana Corp.*, 358 B.R. 567, 584 (Bankr. S.D.N.Y. 2006). In the instant case, the Incentive Plan is designed to create incentives for the Essential Employees to achieve the successful liquidation and wind-down of the Debtor’s estate for the benefit of its creditors.

21. Section 503(c)(3) of the Bankruptcy Code prohibits “transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case.” The Incentive Plan clearly is justified by the “facts and circumstances” of this case, and as such, the prohibition set forth in section 503(c)(3) of the Bankruptcy Code does not apply.

22. The standard for approval under the “facts and circumstances” test of section 503(c)(3) is similar to the standard for approval under section 363(b)(1) of the Bankruptcy Code. *See, e.g., In re Nobex Corp.*, No. 05-20500, 2006 WL 4063024, at *3 (Bankr. D. Del. Jan. 19, 2006) (holding that sale-related incentive compensation was not prohibited by section 503(c)(3) of the Bankruptcy Code where the standards of section 363 of the Bankruptcy Code were satisfied). Courts have examined certain factors to determine if incentive-based compensation programs are appropriate under § 503(c)(3). The factors reviewed by Courts include, but are not limited to, the following: (i) whether the plan is calculated to achieve the desired performance; (ii) whether the cost of the plan is reasonable within the context of the debtor’s assets, liabilities, and earnings potential; and (iii) whether the scope of the plan is fair and reasonable. *See, e.g., In re Global Home Products*, 369 B.R. at 786, *citing, In re Dana Corp.*, 358 B.R. at 576-77.

23. It is clear that the Essential Employees are key to maximizing the Debtor’s assets. The Essential Employees are very familiar with the Debtor’s numerous specialized assets, its books and records and pension plan. This knowledge is irreplaceable and cannot simply be transferred to temporary workers hired to replace the Essential Employees. In addition, the

Debtor respectfully submits that hiring such temporary workers would force the estate to incur additional, extensive costs and expenses to train the temporary workers and impart the essential institutional knowledge already possessed by the long-time Essential Employees.

24. The Debtor also respectfully asserts that the Incentive Payments are reasonable given the amount of funds to be obtained from the liquidation of the Debtor's estate and the extra expense that would be incurred by the Debtor in the event it is required to hire and train temporary workers to replace the Essential Employees. Further, the Essential Employees will not receive the payments under the Incentive Plan in the event they do not fully assist the Debtor in maximizing the benefit to the estate.

25. Moreover, the Incentive Plan is structured in a manner that will not harm the Debtor's estate. The Incentive Plan ensures that the Debtor will continue to receive the maximum benefit of the collective knowledge of the Essential Employees. Moreover, only 50% of the Incentive Payments will be distributed to each Essential Employee on his/her respective last day of employment. The remaining 50% of the Payments will be distributed only to those Essential Employees who subsequently exhaust their 26 weeks of regular unemployment insurance benefits and who do not obtain new employment. Any unused Incentive Payments will be returned to the Debtor's estate.

26. Finally, the Incentive Plan is consistent with plans approved in other chapter 11 cases. *See, e.g., In re Dana Corp.*, 358 B.R. 567 (approving incentive bonuses to certain employees); *In re Nobex*, 2006 WL 4063024, at *3 (approving sale-based incentive compensation where key executives' sale efforts would extend beyond their ordinary duties).

27. Accordingly, based upon the foregoing, the Debtor respectfully submits that the terms of the Incentive Plan not only are justified and reasonable under the circumstances, but also are critical to the successful outcome of this case and fully authorized under the Bankruptcy Code. The Debtor has set forth valid and reasonable business reasons for implementation of the Incentive Plan and respectfully requests that the Court approve the Incentive Plan.

28. No prior request for the relief sought in this Motion has been made by the debtor to this or any other Court in connection with this chapter 11 case.

29. Notice of this Motion has been given to (a) the Office of the United States Trustee, (b) counsel to the Official Committee of Unsecured Creditors, (c) counsel for Fulton Savings Bank, (d) the New York State Office of the Attorney General, (e) all Essential Employees and (f) all parties filing Notices of Appearance and requests for papers in this case.

WHEREFORE, the Debtor respectfully requests that the Court enter an Order pursuant to §§ 105, 363(b) and 503 of the Bankruptcy Code approving and authorizing the key employee incentive plan proposed by the Debtor, and granting such other and further relief as the Court deems just and proper.

Dated: June 4, 2009
Syracuse, New York

Respectfully Submitted,

BOND, SCHOENECK & KING, PLLC

By: Camille W. Hill

Stephen A. Donato, Esq., of counsel

Bar Roll No. 101522

Camille W. Hill, Esq., of counsel

Bar Roll No. 501876

Attorneys for debtor and debtor in possession

The Albert Lindley Lee Memorial Hospital

a/k/a A.L. Lee Memorial Hospital

Office and Post Office Address:

One Lincoln Center

Syracuse, New York 13202

Tel: (315) 218-8000

Fax: (315) 218-8100

EXHIBIT A

Essential Employees

<u>Employee</u>	<u>Title</u>	<u>Proposed Termination Date</u>
Dennis Casey	Executive Director	December 31, 2009
Shirley Seabury	Assistant Director/Operating Officer	December 31, 2009
Louise Sperati	Administrative Assistant	August 28, 2009
Krista Fox	Human Resources Manager	July 31, 2009
Kim Rossiter	Accounting Supervisor	July 31, 2009
Kathy Harris	Equipment/inventory specialist	August 28, 2009
Helen Flora	Accounts receivable/accounts payable	December 31, 2009

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

THE ALBERT LINDLEY LEE MEMORIAL HOSPITAL
a/k/a A.L. LEE MEMORIAL HOSPITAL,

Case No. 09-30845
Chapter 11 Case

Debtor.

ORDER APPROVING KEY EMPLOYEE INCENTIVE PLAN

Debtor The Albert Lindley Lee Memorial Hospital, a/k/a A.L. Lee Memorial Hospital (the "Debtor"), having moved this Court for an Order, pursuant to 11 U.S.C. §§ 105, 363(b) and 503, authorizing and approving the implementation of a program which will provide certain employees with incentive payments to continue maximizing the value of the Debtor's assets and providing for the orderly liquidation of the Debtor's estate for the benefit of its creditors;

NOW, upon reading and filing the Affidavit in Support of Application for Order Reducing Time for Hearing to Consider Debtor's Motion for Order Approving Key Employee Incentive Plan sworn to the 4th day of June, 2009, the Order Reducing Time for Notice of Hearing to Consider Debtor's Motion for Order Approving Key Employee Incentive Plan dated June 4, 2009, the Notice of Motion by Debtor for Order Approving Key Employee Incentive Plan dated June 4, 2009 and the Motion by Debtor for Order Approving Key Employee Incentive Plan dated June 4, 2009 (the "Motion") in support of the relief requested; and upon reading and filing the Affidavit in Response to Motion by Debtor Approving Key Employee Incentive Plan sworn to by Lee E. Woodard, Esq. on the 8th day of June, 2009 on behalf of Fulton Savings Bank; and a hearing concerning the Motion having been held by the Court on June 8, 2009 in

Syracuse, New York; and the Debtor having appeared by Bond, Schoeneck & King, PLLC (Stephen A. Donato, Esq., of counsel) in support of the relief requested; and appearances having been entered on behalf of the Official Committee of Unsecured Creditors by Arent Fox LLP (Robert M. Hirsh, Esq., of counsel), Fulton Savings Bank by Harris Beach PLLC (Lee E. Woodard, Esq., of counsel) and the Office of the United States Trustee by Guy A. Van Baalen, Esq.; and upon due deliberation of the Court and good cause appearing therefor, it is hereby

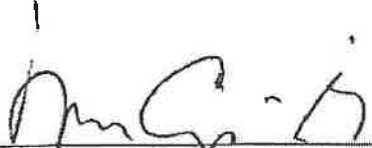
ORDERED, that the Motion is granted in its entirety; and it is further

ORDERED, that the Incentive Plan proposed by the Debtor, as more fully described in the Motion, is hereby approved in its entirety; and it is further

ORDERED, that the employees identified in the corrected Exhibit "A" attached hereto are eligible to participate in the Incentive Plan; and it is further

ORDERED, that this Court shall retain jurisdiction with respect to any and all matters related to, or arising from, the implementation of this Order.

Dated: June 8, 2009
Syracuse, New York



Hon. Margaret Cangilos-Ruiz
United States Bankruptcy Judge

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

THE ALBERT LINDLEY LEE MEMORIAL HOSPITAL
a/k/a A.L. LEE MEMORIAL HOSPITAL,

Debtor.

Case No. 09-30845
Chapter 11 Case

2009 JUN -8 PM 2:48
CLERK OF THE
BANKRUPTCY COURT
N. DIST. OF N.Y.
SYSTEMS USE

FILED

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(Robert M. Hirsh, Esq., of counsel), Fulton Savings Bank by Harris Beach PLLC (Lee E.
Woodard, Esq., of counsel) and the Office of the United States Trustee by Guy A. Van Baalen,
Esq.; and upon due deliberation of the Court and good cause appearing therefor, it is hereby

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Dated: June 8, 2009
Syracuse, New York

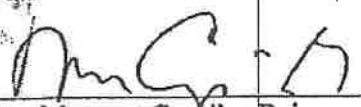

Hon. Margaret Cangilos-Ruiz
United States Bankruptcy Judge

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Exhibit "F"

Summary	Original # Participants	Original @ \$800m	Distributed	Remaining	# Participants	\$ Salary	Proposed @ \$800mm	Interim Payment	Paid @ Event	DELTA
KEIP System	9	\$ 4,160	\$ -	\$ 4,160	7	\$ 4,203	\$ 3,051	\$ 610	\$ 2,441	\$ (1,108)
KEIP Entity	16	1,585	1,058	528	6	2,194	549	55	494	21
KERP	20	1,281	888	393	7	1,354	406	41	366	13
KERP - Discretionary	-	-	-	-	n/a	n/a	350	35	315	350
Total	45	\$ 7,026	\$ 1,945	\$ 5,081	20	\$ 7,751	\$ 4,356	\$ 741	\$ 3,615	\$ (725)

Exhibit "G"

Filed Under Seal