

August 5, 2000

Peninsula Healthcare District  
1783 El Camino Real  
Burlingame, CA 94010  
Attn: Sue Smith, Chair

Re: Restructured Relationship with Mills-Peninsula Health Services

Dear Ms. Smith:

This letter formally acknowledges Mills-Peninsula Health Services ("MPHS") is undertaking a planning process with input from the Peninsula Healthcare District ("District"), to plan and evaluate the construction of a replacement facility to replace Peninsula Hospital with a facility that meets state mandated seismic standards. Provided that the planning process produces a Master Plan that is approved by the District, MPHS and Sutter Health, MPHS and the District anticipate that MPHS and the District would enter into an amendment to the existing Amended and Restated Lease between the parties dated as of January 25, 1985 (the "Lease"), and a new fifty year ground lease (the "Ground Lease") to replace the amended Lease once the new facility has been constructed. In addition to the Ground Lease, the parties anticipate entering into an Operating Agreement pursuant to which MPHS would agree to construct and own a replacement facility at Peninsula hospital that would conform with state mandated seismic standards and to transfer certain other medical office buildings to the District. These transactions, together with the amended Lease and Ground Lease shall collectively be referred to as the "Restructured Relationship." The existing litigation between the District, MPHS and Sutter Health would be dismissed with prejudice upon commencement of the Restructured Relationship. The terms of this letter are intended to document discussions of the parties to date, but with the exception of Paragraphs B and C, the terms of this letter are not legally binding and enforceable except to the extent described in Paragraph E hereof.

- A. Negotiations. District and MPHS intend to negotiate with the purpose of agreeing upon the terms of an amended Lease, a Ground Lease, and an Operating Agreement, (collectively, the "Agreements") all as described in the Term Sheet attached hereto as Attachment 1 (the "Term Sheet"). District, MPHS and Sutter Health, expect that the principal terms of the Agreements shall substantially reflect the provisions of the Term Sheet. However, neither the Term Sheet nor this letter contain binding agreements of MPHS, District or Sutter Health, except for the provisions of Paragraphs B and C which are binding. All tentative agreements shall become binding only upon satisfaction of the conditions described in Paragraph E.
- B. Exclusive Negotiations. During the period from the date of this letter through December 31, 2000 (the "Negotiating Period"), District and MPHS agree to negotiate on an

exclusive basis with each other for the transactions contemplated herein. Notwithstanding the foregoing, the parties agree to continue negotiations beyond December 31, 2000 so long as they are progressing in good faith and due diligence. Should either party determine that negotiations are not so progressing, they may, at any time after December 31, 2000, terminate the Negotiating Period, and this Letter of Intent, by delivering to the other written notice of intent to terminate negotiations. Such notice shall be effective upon delivery.

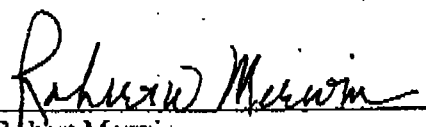
- C. Authorization. District, MPHS and Sutter Health represent and warrant that the execution, delivery and performance of this letter has been duly authorized by their respective Boards of Directors or the appropriate Committees thereof.
- D. Legal Requirements. The terms of any Agreements entered into pursuant to this letter shall not include any provision which the general counsel of either District or MPHS determines, in good faith and relying on substantial legal authority, will violate or creates substantial risk of violating either (i) the state or federal antitrust laws; (ii) the Medicare and/or Medicaid statutes or regulations; (iii) state or federal laws and regulations imposed upon tax-exempt entities or upon entities financed through tax-exempt bonds; (iv) the Health Care District Law; (v) binding and enforceable contracts to which either District or MPHS is a party; or (vi) any other state or federal law which governs the activities of either party.
- E. Effect of Letter. This is a letter of intent only. It does not bind District, MPHS or Sutter Health to consummate the Restructured Relationship and no party shall be obligated to proceed with the Restructured Relationship, unless each of the following conditions is satisfied: (i) definitive written Agreements are reached and consents obtained; (ii) each party's Board of Directors, has approved the definitive written Agreements, which approval may be withheld at the sole discretion of any such Board; (iii) voter approval of the residents of the District has been received for the actions described in Section 6 of the Term Sheet; and (iv) the definitive written Agreements have been executed by authorized representatives of each party thereto.

MPHS is excited by the opportunities presented by this Restructured Relationship. We look forward to continuing to work with you.

Sincerely yours,


MILLS PENINSULA HEALTH  
SERVICES

By: \_\_\_\_\_

  
Robert Merwin

Its: Chief Executive Officer


SUTTER HEALTH

By: 

Patrick Fry  
Its: Chief Operating Officer  
Executive Vice President

Accepted and approved as of the 20<sup>th</sup> day of October, 2000.

PENINSULA HEALTHCARE DISTRICT

By:   
Board Chair

By: \_\_\_\_\_

**Revised District Term Sheet  
August 5, 2000**

Attachment 1

Term Sheet

Restructured Relationship  
Between  
Peninsula Healthcare District  
And  
Mills-Peninsula Health Services

**1. Ownership of MPHS Properties**

Promptly after the Voter Approval described in Section 6 and simultaneously with the execution of the Amended Lease described in Section 3, MPHS and the District would sign an Operating Agreement and Ground Lease under which MPHS would return and/or transfer ownership of the following properties to the District: (1) the "front lawn;" (2) 1515 Trousdale; (3) the Blood Bank (the front lawn, 1515 Trousdale and the Blood Bank are collectively called the "Peninsula Hospital Properties"); (4) 1720 El Camino; (5) 1811 Trousdale; (6) 1600 Trousdale; (7) 1848-1850 El Camino (the properties listed as items 4, 5, 6 and 7 are collectively called the "Medical Office Buildings") and (8) the Marco Polo lot.

The Operating Agreement and Ground Lease would also provide that the District would ground lease all of the real property constituting the Peninsula Hospital Properties to MPHS for a term to commence immediately and to terminate 50 years from the Start Service Date (as defined in Section 3 below). The Operating Agreement and Ground Lease would include, in addition to the Peninsula Hospital Properties, any other portion of the existing hospital grounds owned by the District which is required by the District approved Master Plan for hospital facilities, grounds or parking. The District shall have absolute discretion over the development of the properties listed as items (4) through (8). All properties included under the Operating Agreement and Ground Lease (e.g., the front lawn, 1515 Trousdale, the Blood Bank, and any other portion of the existing hospital grounds owned by the District which is required by the District approved Master Plan for hospital facilities, grounds and parking) will be referred to as the "New Peninsula Site." The Operating Agreement and Ground Lease would include provisions requiring the District to terminate in a timely manner any leases with third parties of building space at 1515 Trousdale and/or the Blood Bank to allow demolition of such buildings in order for the New Facility described in Section 2 to be constructed.

All properties returned or transferred from MPHS to the District will be transferred free and clear of any liens or encumbrances, subject to leases entered into by MPHS in the ordinary course of business. MPHS would not enter into any new leases or discretionary renewals with a term which extends beyond 12/31/2001 without the approval of the Chair of the District Board.

## **2. Construction of New Facility**

MPHS would design and build a newly constructed hospital (the "New Facility") on the New Peninsula Site. The New Facility would be built in conformity with seismic standards, at no District cost and in substantial conformity and compliance with a Master Plan approved by the District. MPHS would own the New Facility during the term of the Operating Agreement and Ground Lease.

MPHS would complete the New Facility by the date legally required by SB 1953. If the legally required date is pushed back from January 1, 2008, MPHS will nonetheless use reasonable best efforts consistent with Sutter Health's ability to meet its financing obligations, to complete construction by January 1, 2008.

In no event may the date of completion of the New Facility be pushed back beyond December 31, 2012. In order to meet this alternative completion date, (1) failure to fully commence construction by December 31, 2009, or (2) failure to subsequently maintain a construction timeline reasonably designed to meet the completion deadline, or (3) failure to complete the New Facility by December 31, 2012 would each be a breach of the Operating Agreement and Ground Lease.

MPHS would remain responsible for any then existing debt secured by the Peninsula hospital site or revenues.

## **3. Amended Lease**

The existing Restated and Amended Lease between MPHS and the District (the "Restated Lease") would be amended promptly after Voter Approval, with the amendment to cover the time period from Voter Approval until the New Facility is operational (hereafter, the "Start Service Date"). The lease rate during such period (the "Interim Period") would be One Dollar (\$1.00) per year. The maintenance obligations of the existing Restated Lease will continue during the Interim Period. The replacement obligations of the existing Restated Lease will continue until such time as MPHS has all enforceable construction contracts and construction permits in place for construction of the New Facility and has in fact "broken ground" on the New Facility. However, in the event that MPHS is required to replace the Leased Premises prior to the date required by SB 1953, as a result of destruction of the Leased Premises by a seismic event or any other cause, the Amended Lease would be terminated as of the Start Service Date and the provisions of the Operating Agreement and Ground Lease pertaining to operation of the New Facility would be fully effective.

MPHS would be responsible for the cost of demolition of the current Peninsula facility.

The Amended Lease would also require MPHS to spend a minimum of One Hundred Thousand Dollars (\$100,000) (the "Aesthetic Refurbishment Amount") per year during the Interim Period for aesthetic refurbishments to the public and patient internal spaces of the Leased premises. Such aesthetic refurbishments include but are not limited to items such as carpet, paint, draperies and furnishings. The Aesthetic Refurbishment Amount described above would be increased starting the calendar year immediately following Voter Approval and each year thereafter by the same percentage increase as the Consumer Price Index for the Bay Area. Notwithstanding the foregoing, MPHS may request the District to allow it to utilize some or all of the Aesthetic Refurbishment Amount for equipment or other maintenance purposes and the District shall consider such request.

#### 4. Maintenance & Insurance.

The Operating Agreement would provide that starting with the 7<sup>th</sup> year following the Start Service Date and ending with the 50<sup>th</sup> year following such Date (unless extended by mutual agreement of the District and MPHS) MPHS would spend a minimum of two percent (2%) of its annual budgeted hospital operating expenses on maintenance and/or capital improvements to the New Facility and grounds. Any new building code improvement costs required by regulation during the term of the Operating Agreement would be paid by MPHS.

During the Operating Agreement and Ground Lease term, MPHS would provide and pay for all insurance coverage of types and coverage limitations standard for the industry. Notwithstanding the foregoing, MPHS could determine in its own discretion whether to maintain earthquake insurance on the New Facility. However, starting on the 35<sup>th</sup> year after the Start Service Date, the District could elect to pay for fifty percent (50%) of the cost of earthquake insurance on the New Facility, in which case MPHS would be obligated to pay for the other fifty percent, and would be obligated to maintain such insurance.

The Operating Agreement and Ground Lease would provide that if, during its term, the New Facility is partially or totally destroyed, whether or not from a risk covered by insurance, MPHS would promptly and expeditiously make the repairs necessary to restore the New Facility to a condition for occupancy or use as good as the condition before such destruction, or MPHS could elect to demolish and reconstruct the improvements which were damaged or destroyed, with the goal being to produce a reconstructed facility which meets the Occupancy Standard described in Section 13 of this Term Sheet, or such different Occupancy Standard to which MPHS and the District may agree. The repairs and restorations of the New Facility would be part of the New Facility which would be transferred to the District upon expiration of the Operating Agreement and Ground Lease.

If the damage or destruction occurred during the first thirty-five (35) years of the Operating Agreement and Ground Lease, MPHS would not have any right to reimbursement or refund for the cost of repairs and restorations upon expiration of the Operating Agreement and Ground Lease.

If the damage or destruction occurred after the first thirty-five (35) years of the Operating Agreement and Ground Lease, and if the cost of repairs and restorations was covered by insurance, MPHS would not have any right to reimbursement or refund upon expiration of the Operating Agreement and Ground Lease. If the cost of repairs and restorations was not covered by insurance (either because such insurance was not available or, in the case of repairs and restorations necessitated by a seismic event, because the District did not elect to pay for 50% of such insurance), the District would reimburse MPHS for the book value of the repairs and restorations upon termination of the Operating Agreement and Ground Lease.

**5. Rent.**

Except as provided in this Section, no rent or other payment would be owing from MPHS to the District under the Operating Agreement and Ground Lease. If the State of California eliminates or reduces the District's taxing authority, MPHS would pay the District an annual dollar rental. Such amount would be payable starting in the first year that the District's taxing authority is eliminated, through the termination of the Operating Agreement and Ground Lease. The dollar rental amount would be calculated in the first year by making up any shortfall between the amount of taxes raised by the District (if any) and \$250,000 (increased by the same percentage increase as the Consumer Price Index for the Bay Area, with the increases commencing with calendar 2000) (the "Minimum Amount"). Thereafter, the Minimum Amount will be increased annually, by the same percentage increase as the Consumer Price Index for the Bay Area.

**6. Voter Approval.**

At a time mutually agreeable to MPHS and the District, (but anticipated to be prior to 03/31/2001), a measure would be placed on the ballot of the District to seek Voter Approval to authorize the District to:

- (1) approve the Master Plan for the New Facility;
- (2) enter into the Amended Lease for the Interim Period;
- (3) enter into the Operating Agreement and Ground Lease pursuant to which the District would ground lease to MPHS the Peninsula Hospital Properties for a period to terminate 50 years from the Start Service Date of the New Facility; as described in this Term Sheet; and
- (4) dismiss the litigation as described in Section 16.

The approval of 50% (plus one) of the residents of the District who vote in the relevant election would be required. The District Board and MPHS would support the ballot measure within legal parameters. MPHS would pay for reasonably incurred election costs.

**7. Renewal of Operating Agreement and Ground Lease.**

Fifteen years in advance of the expiration of the Operating Agreement and Ground Lease, the District and MPHS would begin a process of meeting and conferring

regarding extension of the Operating Agreement and Ground Lease or transition for termination at the 50<sup>th</sup> year. If the parties agree to extend, and if any lease of District assets must be extended beyond its current term, the Board of Directors of the District may require a new vote of the District's electorate to be held. The Operating Agreement and Ground Lease would provide for detailed exit strategies that protect the parties' interests and assets.

**8. Use of "District Controlled" Portion of Peninsula Site.**

Upon demolition of the existing Peninsula buildings (e.g., following the Start Service Date of the New Facility), the District would assume control of the portion of the Peninsula site which is not part of the New Peninsula Site (hereafter, the "District Controlled Land") for use for healthcare purposes which are non-competitive with services or programs of MPHS located within the District. At least once annually during the term of the Operating Agreement and Ground Lease, MPHS would provide the District with a complete updated list of services or programs actually being provided by MPHS within the District (the "Existing Program List"). The District would not use District Controlled Land for purposes that are competitive with any service on the Existing Program List, without the consent of MPHS, which consent shall not be unreasonably withheld. If MPHS does not respond within ninety (90) days to a District request to use District Controlled Land for a purpose which is competitive with a service on the Existing Program List, MPHS shall be deemed to have consented. Further, if the District approved Master Plan provides for a service or program that MPHS intends to commence at a specified future date (hereafter, an "Approved Future Service") the District shall not, without the prior written consent of MPHS (which shall not be unreasonably withheld) use District Controlled Land for purposes which are competitive with any Approved Future Service, provided that construction of any facilities required for such Approved Future Service is commenced within three (3) years of the construction commencement date set forth in the Master Plan, and that construction is completed expeditiously.

At least twice annually during the term of the Operating Agreement and Ground Lease, the District would meet and confer with MPHS concerning proposed uses of the District Controlled Land. The District shall use its District Controlled Land for purposes which are health care related and are complementary with services and programs of MPHS.

During the term of the Operating Agreement, the District would retain the right to convert surface parking land to District Controlled Land upon securing equivalent and accessible parking volume through District construction of a parking structure. The Master Plan shall identify an area mutually agreed to for designation as a future site of a potential District constructed parking structure.

**9. District Repurchase Obligation**

The District would be relieved from any obligation to repurchase any of the assets bought by MPHS on the closure of the existing "old" Peninsula Hospital; such assets would continue to be owned by MPHS.

Commencing 15 years prior to the expiration of the Operating Agreement and Ground Lease, MPHS would seek District approval in advance of making any capital expenditure for a structural improvement or other capital asset that is integral to the operation of the New Facility and that will have a useful life (book value according to generally accepted accounting principles) extending beyond the termination of the Operating Agreement and Ground Lease. If the District approved a proposed capital expenditure, it would reimburse MPHS for the book value of the capital asset upon termination of the Operating Agreement and Ground Lease. If the District did not approve the capital expenditure, MPHS could nevertheless make the expenditure, but the District would have no obligation to reimburse MPHS for such capital asset upon termination of the Operating Agreement and Ground Lease.

Upon termination of the Operating Agreement and Ground Lease, MPHS could remove all equipment, furniture and other assets not integral to the operation of the New Facility. Alternatively, MPHS and the District could agree that the District would purchase some or all of such assets. At year 40 of the Operating Agreement and Ground Lease (if the parties have not agreed to extend the term of the Operating Agreement and Ground Lease beyond 50 years) MPHS and the District would meet and confer to determine whether the District would purchase the equipment, furniture and non-integral assets at the termination of the Operating Agreement and Ground Lease

#### 10. Maintenance of Services.

At a minimum, MPHS would at all times during the term of the Operating Agreement and Ground Lease maintain an in-patient acute care facility and a 24 hour 365 day walk-in "Basic" Emergency Room service at Peninsula Hospital. MPHS would maintain all standard licenses and accreditations for the Peninsula facilities.

On or before October 1, 2000, MPHS and the District would develop a list of other core healthcare services (excluding the Basic Emergency Room Service) (hereafter "Core Clinical Services") over which the District would have certain approval rights prior to termination of such Core Clinical Services. It is the intent that the list of Core Clinical Services would be limited to fundamental hospital services. During the term of the Operating Agreement and Ground Lease, prior to termination of any Core Clinical Service, MPHS would consult with the District and the leadership of the nursing staff and the leadership of the Professional Staff of MPHS, and would obtain District approval as hereinafter described. As described in Section 16, MPHS would hold at least two (2) public meetings on the proposed termination over a period of not less than 60 days prior to terminating any Core Clinical Service at the Peninsula site.

To gain District approval of the proposed termination, MPHS would be required to demonstrate to the District Board that one of the following factors (the "Termination Factors") exists:

- a. The service is uneconomic to MPHS, or
- b. Quality is deficient because of low incidence, or

- c. No community need exists and/or need is being adequately met by another provider within the County of San Mateo.

If the District disagreed with MPHS' belief that one of the above Termination Factors exists with respect to the Core Clinical Service proposed to be terminated, the issue would be submitted to binding arbitration by three independent nationally recognized accounting or health management consultants; one selected by the District; one selected by MPHS; and the third selected by the other two. If the arbitrators determined by a preponderance of the evidence that a Termination Factor existed with respect to the Core Clinical Service proposed to be terminated, MPHS could terminate such Core Clinical Service; if the arbitrators determined that a preponderance of the evidence did not support the existence of a Termination Factor with respect to the Core Clinical Service, MPHS could not terminate such Core Clinical Service, and MPHS could not request termination of the same Core Clinical Service for a period of eighteen (18) months from the date of the arbitrators' determination.

If MPHS' decision to terminate a Core Clinical Service is solely for financial reasons, the District would have the right to fund the service itself or subsidize net losses incurred by MPHS from the service, if the District deemed it appropriate to do so.

**11. Enforcement of MPHS Promises.**

Enforcement of other MPHS promises (master agreement covenants) to be subject to breach of contract provisions. Both parties to agree to binding arbitration of any dispute.

**12. Debt**

Upon termination of the Operating Agreement and Ground Lease (other than as a result of breach by the District), the District would receive the New Facility free and clear, subject to the District obligation to reimburse MPHS for the book value of District approved capital improvements made during the last 15 years of the Operating Agreement and Ground Lease. (See Section 9.)

**13. District Participation in Planning.**

Two District Board members appointed by the District would be voting members of the MPHS Building Committee prior to approval by the District of the Master Plan (estimated to be November 2000). The MPHS Building Committee consists of 13 members. MPHS would present status reports to the full District Board on a quarterly basis.

The District Board would approve the final Master Plan (including size, location, design and services) developed by MPHS prior to Voter Approval; such District approval not to be unreasonably withheld. The goal of the Master Plan would be to size the New Facility such that it will meet an Occupancy Standard of eighty-five percent (85%). (The Occupancy Standard could be revised by mutual agreement of MPHS and the District based on input from the health care planning consultants which they each intend to utilize during the Master Planning process.) Thereafter, any Material Reduction to the New Facility's size prior to completion of construction

would be subject to approval of the District, which approval would not be unreasonably withheld. Material Reduction would be defined as a reduction in number of beds or square footage which exceeds fifteen percent (15%). In the event of dispute between MPHS and the District over the District's failure to approve a Material Reduction to the New Facility's size, the issue would be submitted to binding arbitration. The arbitration would be decided by three nationally recognized health care planning consultants; one selected by the District, one selected by MPHS, and the third selected by the other two. The arbitrators would determine whether the proposed Material Reduction would result in a New Facility which meets the agreed upon Occupancy Standard. If the arbitrators determined by a preponderance of the evidence that the Occupancy Standard would be met after the proposed Material Reduction, the reduction would be approved; if the arbitrators determined by a preponderance of the evidence that the Occupancy Standard would not be met after the proposed Material Reduction, the reduction would not be approved and MPHS would not propose the same Material Reduction to the District for a period of eighteen (18) months from the date of the arbitrators' determination.

The consultant retained by the District to evaluate the proposed plan for the New Facility would receive access to all planning documents reasonably required for him/her to evaluate the proposed plans.

#### 14. Medical Office Buildings

The District would commit that for the term of the Operating Agreement and Ground Lease MPHS may continue to lease \_\_\_\_\_ square feet in the Medical Office Buildings which is currently occupied by MPHS, representing \_\_\_\_\_ percent of the total square footage of the Medical Office Buildings occupied by MPHS, provided that such square footage may be adjusted down on the Start Service Date to the extent that, pursuant to the Master Plan, certain MPHS administrative functions currently located in the Medical Office Buildings are consolidated into the New Facility. Further, if MPHS vacated space in a Medical Office Building at any time, the District need no longer make such space available to MPHS. The rental rate for MPHS would be \$1.00/year together with a pass-through of any and all actual costs of occupancy including but not limited to costs of maintenance, taxes and insurance. Rental payments to the District would adjust to market rent for the building if MPHS subleased its space to any other party at a higher rent.

The District would agree during the term of the Operating Agreement and Ground Lease to continue to use the Medical Office Buildings for medical office purposes and to rent office space to physicians at fair market value rental rates for medical office space of like quality in the area. First priority for such office space would be given to physicians on the MPHS Medical Staff. The District would not use the Medical Office Buildings or the Marco Polo lot for purposes which compete with any service on the Existing Program List or any Approved Future Service, without the prior written approval of MPHS, which approval may not be unreasonably withheld.

MPHS would retain approval rights over any physician tenants in any of the Medical Office Buildings or the Marco Polo lot, who are not on the Medical Staff of MPHS. Such approval may not be unreasonably withheld, and approval must be denied within thirty (30)

days of submission or the subject tenant will be deemed approved by MPHS. MPHS would provide compensation for lost rent for the period the District forgoes market rate rental income (until new tenant is obtained) if a prospective tenant is rejected by MPHS. In addition to all other indemnification provisions to be negotiated for the Operating Agreement and Ground Lease, there would be indemnification of the District by MPHS should tenant rejection by MPHS result in litigation and judgment exposure.

The District would have the opportunity to conduct reasonable due diligence on the Medical Office Buildings immediately upon execution of the proposed non-binding Letter of Agreement. If the District determines that it no longer wishes to own one or more of the properties it may market the property to third parties, provided that (1) MPHS would have a right of first refusal to match any bona fide offer received by the District within 30 days of receipt of a third party offer, and (2) if MPHS did not exercise its right of first refusal to acquire the property and the District sold the property to a third party, the District would acquire equivalent medical office space in the same general vicinity, make such space available to physicians at fair market value rental rates for medical office space of like quality in the area, and provide the same square footage rental space for MPHS as MPHS had in the property which was sold, with such space to be provided under the same rental terms specified in the first paragraph of this section.

If MPHS did not wish to acquire such property, the District could sell such property to a third party for uses that are non-competitive with any service on the Existing Program List or any Approved Future Service.

15. MPHS Request for Support.

MPHS would be able to request financial support from the District for projects or services that benefit the community, such as Ombudsman, Senior Focus, etc. The District could approve or reject such requests.

16. Public Meetings.

MPHS would hold at least two (2) public meetings per year. MPHS will hold two (2) additional public meetings prior to termination of any licensed service at the Peninsula site.

17. Dismissal of Litigation.

Subject to proper procedural steps worked out by counsel for both sides handling these pending matters, all current litigation would be immediately stayed upon execution of this Letter of Intent and dismissed with prejudice upon final Voter Approval as described above.