

August 27, 2013

**BY CERTIFIED MAIL, RETURN RECEIPT REQUESTED
AND BY ELECTRONIC MAIL**

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Vice President & General Counsel
Norton Healthcare, Inc.
4967 U.S. Highway 42, Suite 101
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RE: Notice of default and demand for cure - 1981 Lease and Affiliation and Support Commitments

Dear Mr. Azar:

We represent the University of Louisville ("U of L") as the beneficial owner of a 2.2 acre tract of land and the improvements constructed thereon located at 231 East Chestnut Street in Louisville, Kentucky (the "Real Property"), and as a party to a Lease which grants NKC, Inc. ("NKC" - predecessor in interest to Norton Healthcare) a leasehold interest in the Real Property under the terms and conditions of the Lease ("1981 Lease"). A copy of the 1981 Lease, which consists of two explicitly connected agreements dated August 12, 1981 and December 8, 1981 - and the current version of the Master Affiliation Agreement required by the 1981 Lease - are attached as Exhibits A-1, A-2 and A-3.

This correspondence provides formal written notice under paragraph 12 of the 1981 Lease to Norton Healthcare in its capacity as the successor in interest to NKC under the 1981 Lease, that it is in default in the prompt and full performance of the 1981 Lease and demands that Norton Healthcare cure the default no later than thirty (30) days from the receipt of this letter. Norton Healthcare is also notified that under paragraph 12, upon the expiration of thirty days without full and sufficient cure of such default, the 1981 Lease may be forthwith terminated, and whatever ownership or possessory rights held at that time by Norton Healthcare in the Real Property, including any buildings, structures, fixtures and building equipment, together with all additions, alterations and replacements thereof (excluding movable trade fixtures, machinery, furnishings and equipment) (collectively, "Buildings and Improvements") shall terminate. Paragraph 14 of the 1981 Lease requires Norton Healthcare to, upon such termination, surrender to U of L the ownership and possession of the Real Property and all Buildings and Improvements.

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Likewise, this correspondence provides formal written notice to Norton Healthcare of its breach of the Critical Care Support Agreement and Funding Commitments identified below, and a demand to make payment in full of the past due sums identified below no later than September 25, 2013. If Norton Healthcare fails to fully and timely cure these breaches, U of L will pursue any and all remedies available to it for breach.

The Real Property. The Real Property – along with adjacent tracts - has historically formed a part of contiguous hospital operations located in the City of Louisville. The City of Louisville conveyed the Real Property to the Louisville and Jefferson County Board of Health April 30, 1942. The Board of Health owned and operated what was known as Louisville General Hospital on the Real Property and adjacent tracts until June 30, 1979, when the Real Property was conveyed to the Commonwealth “for the use and benefit of the University.” Beginning in 1979, the Real Property was part of the U of L Hospital campus.

The interests of the parties to the 1981 Lease. In May 1981, newly-formed NKC, which represented the combination of Kosair Crippled Children’s Hospital (then sited on Eastern Parkway) and Norton Children’s Hospital (then housed on the third floor of the Norton-Children’s complex at Chestnut and Brook Streets) decided to consolidate operations in a free-standing pediatric care hospital, which it planned to build in downtown Louisville near its present facilities. NKC identified U of L’s Real Property, which at the time was used for hospital parking, as the desired building site.

The site was particularly attractive because U of L and NKC’s predecessor had been partners in Louisville area pediatric care for decades. In 1981, almost all of the pediatric physician care at Norton Children’s Hospital was provided by U of L faculty and residents and that has continued to the present day. Indeed, of the 75,000 emergency medicine visits and 10,000 inpatient admissions each year at Kosair Children’s Hospital, U of L faculty care for all of the Emergency Department visits and nearly 90% of the inpatient admissions. U of L also provides all services for the emergency department, inpatient medicine (hospitalist) patients, and 80% of the neonatal ICU (NICU) admissions.

And under a series of affiliation agreements in place since 1962, U of L faculty serve as the Chief of Pediatrics, Chief of Surgery and the Chief of Staff of Norton Children’s Hospital; likewise, the medical services of Norton Children’s Hospital have been directed by the corresponding departmental chairs of U of L’s School of Medicine, and U of L recommends the appointment of Chiefs of Service in anesthesiology, radiology, and pathology. As part of the affiliation, Norton Children’s Hospital serves as the U of L School of Medicine’s pediatric teaching hospital and the Hospital makes its patients available for pediatric education and training. It is apparent why U of L was acutely interested in NKC’s proposal, particularly if the

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newly-built pediatric hospital would benefit U of L's School of Medicine by serving as its pediatric teaching hospital.

The August, 12, 1981 agreement. On August 12, 1981, U of L entered into the first of two agreements with NKC to which, along with the revised and updated Affiliation Agreement required by the 1981 Lease, form the 1981 Lease. The parties to the August 12 agreement included U of L and NKC. The mutual covenants of the parties underscore NKC's promise that in exchange for permitting the facility to be built on a publicly-owned asset, it must serve as the School of Medicine's pediatric teaching hospital for the term of the 1981 Lease:

WHEREAS, it will be to the mutual interests and benefit of the parties hereto, in the conduct of their respective programs, that said new pediatric facility be constructed on said property where it will provide pediatric care, service and education benefitting the U of L Medical School and the citizens of the Commonwealth of Kentucky.

NKC's covenant to assure that the publicly-owned asset serve as U of L's pediatric teaching hospital is accompanied by a series of agreements. Since the new free-standing facility was to serve as the School of Medicine's pediatric hospital, the transparency of NKC's planning and operations was critical. NKC agreed that it would "continue the practice" of inviting U of L medical staff to Board of Directors and Executive Committee meetings "to assure full and open communication between them." Further, NKC promised to invite a member of U of L's board of trustees to NKC's Board of Directors and Executive Committee meetings.

The Affiliation Agreement. As part of Kosair Children's Hospital's commitment to continue its historic affiliation with U of L as the School of Medicine's pediatric teaching hospital, NKC was required to review, update and execute the existing Affiliation Agreement executed in 1962. Without an updated Affiliation Agreement which keeps pace with the changing needs and growth of the institution - and the Pediatric Department of the School of Medicine - U of L cannot sustain the excellence in pediatric care and teaching demanded by the public it serves. The new Affiliation Agreement is described as covering the "long-standing relationship" between Children's Hospital and U of L, "particularly the Department of Pediatrics."¹ The terms and conditions of the Affiliation Agreement as currently revised and updated, are *required by the Lease* and therefore form part of the 1981 Lease.

The December 8, 1981 agreement. The December 8, 1981 agreement jointly designates U of L, the beneficial owner of the Real Property, and the Commonwealth, which holds *legal* title to the Real Property, as the "Lessor" under the 1981 Lease. In addition to expressly incorporating the August 12 agreement "by reference" and providing that the August 12 agreement "shall survive the execution of the Lease," NKC covenanted:

¹ NKC also agreed to provide 200 onsite parking spaces to the University in the new facility.

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[The] new pediatric facility . . . will serve the interests of and will be to the benefit of the Lessor by the availability of said new pediatric facility for the programs and use of the University of Louisville's School of Medicine

In exchange for the benefit of the new pediatric facility for the programs and use of U of L's School of Medicine, the continuation of an updated and revised Affiliation Agreement for the support of U of L's teaching hospital, departments and faculty, payment of \$1.00 annual rent payable in advance, and a one-time grant of \$592,041.67 to the University of Louisville Foundation restricted to pediatric care, education and research, NKC received a 99-year lease of the Real Property, including the right to construct and operate a pediatric hospital on the site.

Defaults under the 1981 Lease, Critical Care Support Agreement and Pediatric Funding Commitments. Norton Healthcare is in default in the prompt and full performance of the 1981 Lease as the result of three separate but related actions. Any one of the three actions is a sufficient predicate for default and subsequent termination, if not timely and adequately cured. All three breaches threaten the care of pediatric patients in this community, as over 90% of patients at Kosair Children's Hospital are cared for by U of L physicians. Removal of funding for U of L physician care and the U of L Pediatric Department is reduction of funding for patient care and improved patient outcomes.

First, Norton Healthcare has breached its covenant to operate Kosair Children's Hospital for the programs and use of U of L's School of Medicine by unilaterally restricting U of L from providing pediatric care, teaching and research at the hospital by physicians in the pediatric specialties of anesthesiology, radiology and neurosurgery. Norton Healthcare cannot deny permission to U of L School of Medicine faculty from doing precisely what is contemplated in a teaching hospital - to care for, educate and teach. This breach has rendered futile any effort by U of L to recruit and retain physicians in these pediatric specialties. U of L demands that Norton Healthcare cure this breach within thirty days by confirming in writing that in the event U of L retains credentialed physicians in these specialties, they will be granted full privileges at Kosair Children's Hospital to render care, and teach and educate students and residents.

Second, Norton Healthcare has engaged in a course of conduct which prevents U of L in general - and U of L's Pediatric Department in particular - to maintain the excellent and competitive level of pediatric programs and faculty that the community requires and expects. Since negotiations officially commenced in Spring 2010, Norton has (a) refused to pay amounts due to U of L under a Critical Care Support Agreement and has refused to honor other funding commitments made by Norton Healthcare and relied upon by U of L; (b) failed for a period of at least four years to negotiate in good faith with U of L to amend the existing Master Affiliation Agreement to provide sufficient funding to sustain the Pediatric Department's patient care,

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education and teaching at the pediatric hospital; (c) refused to permit the School of Medicine medical staff to attend meetings of the board of directors or executive committee meetings of NKC and its successor, Norton Healthcare, and refused to permit a member of U of L's Board of Trustees to attend the same meetings – all as required by paragraph 1 of the August 12, 1981 agreement, which forms a part of the 1981 Lease.

Norton's refusal to pay \$8,008,399 due to U of L during the period January 1, 2009 through July 31, 2013 includes the breach of the Agreement for Provision of Pediatric Critical Care and Sedation Services ("Critical Care Support Agreement") (Ex. C). Under the Critical Care Support Agreement, Norton Healthcare agreed to pay "compensation for the services furnished hereunder" as set forth in Attachment D thereto.² Attachment D requires Norton Healthcare to pay, among other sums, a "Group Guarantee" based in part upon an "Income Guarantee" formula which takes into account net revenue, and total operating expenses (including the salaries and expenses of physicians and nurse practitioners).

The Critical Care Support Agreement requires Norton Healthcare to adjust its payments each year, based on what U of L is required to pay in increased salaries and expenses and the cost of newly recruited and hired physicians and nurse practitioners. For the period July 1, 2009 to the present, U of L has had to increase both physician and nurse practitioner full-time equivalents ("FTEs") and their pay, and has paid these increased expenses to meet patient care demands and to meet market competitive forces. Despite repeated demands, Norton Healthcare has refused to pay for these services and expenses which reflect care to their patients. Norton Healthcare has refused to pay the sums due and owing on the promise that it will not honor its funding commitments *until* U of L and Norton Healthcare sign a new Master Affiliation Agreement. Norton Healthcare has further refused to amend the Critical Care Support Agreement to reflect the costs which they have agreed to pay under Attachment D. The amount past due under the Critical Care Support Agreement for the last three fiscal years is \$1,728,615.

U of L has also incurred substantial expenses in reliance upon Norton Healthcare's funding commitments which have not been reimbursed by Norton Healthcare. U of L has recruited, hired and paid pediatric staff physicians and fellows and made substantial out-of-pocket payments for necessary administrative support. This support is related to the residency program and required by pediatric accreditation bodies. Norton Healthcare has refused to pay for these expenses, including Medical Education Administrative Support (\$4,534,123 past due over the period January 2009-June 2013), Funding Support for Recruitment of New Faculty (\$1,645,661 past due over the period January 2010-June 2013) and Expenses for Pediatric

² See Section 8.01 and Attachment D, titled "Compensation to Department of Pediatrics for Pediatric Critical Care and Sedation Services."

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Fellowships (\$100,000 past due for the period July 2012-July 2013).³ Like the funds due under the Critical Care Support Agreement, Norton Healthcare has advised that it will not honor its funding commitments *until* U of L and Norton Healthcare sign a new Master Affiliation Agreement. Norton Healthcare is estopped from refusing to honor these commitments, upon which U of L reasonably relied to its detriment.

This failure to honor funding commitments is particularly egregious because Norton Healthcare has withheld commitments while it refused to negotiate in good faith to reach an Affiliation Agreement since the Spring of 2010. After prolonged delays, representatives of both parties met in Chicago in early October 2011 and Norton Healthcare agreed to pay *only* ½ of the incremental annual funding required to provide adequate support - \$8,000,000.⁴ This still-insufficient commitment remained unfulfilled until Norton Healthcare's representatives repeated the commitment as part of a term sheet on September 28, 2012. Despite this commitment, Norton Healthcare has refused to pay *any* of the of the incremental annual fund increases promised since October 2011 - in addition to its *embargo* of the now \$8,008,399 in other specific funding identified above.

By refusing to pay amounts due and withholding adequate funding support, Norton Healthcare has caused U of L's Pediatric Department to sustain operating deficits and threatens its ability to serve the pediatric hospital's patients and train new physicians. U of L's ability to retain its physicians and continue to provide the excellence of care the community requires is directly compromised as a result.⁵ While Norton Healthcare withholds these funds, it has continued to take steps to erode the patient base available to U of L physicians and the revenue associated with it, *e.g.*, by employing a group of neonatologists in January 2012 to compete with U of L neonatologists at Kosair Children's Hospital, thereby diverting patient service revenue and teaching cases away from U of L neonatologists.

This course of conduct, coupled with the recent Letter of Intent described below, not only constitutes a breach of the Critical Care Support Agreement and the Funding Commitments, but a breach of its obligation to perform its covenant under the 1981 Lease to benefit the U of L School of Medicine and provide a pediatric teaching facility in good faith. U of L demands that

³ Norton Healthcare recently offered - *in lieu of the existing funding commitments described above* - a \$2 million one-time "gift" related to Medical Education with the "possibility" of future funding; payment of \$450,000 to support the hiring of one additional pediatric surgeon and to increase salaries of current surgeons; \$700,000 for additional support under the Critical Care Support Agreement amendment effective July 2013; \$200,000 for two separate fellowships beginning July 2013; and \$150,000 to support research efforts of a new pediatric neurologist, dependent on a U of L matching payment. This offer falls well short of Norton Healthcare's existing commitments.

⁴ The incremental annual increase in funding was composed of \$3.5 million for clinical program development, \$3.5 million for research and \$1.0 million for Graduate Medical Education.

⁵ For example, Norton Healthcare's refusal to honor its funding commitments has caused the shutdown of U of L's *Healthy for Life* clinic, which treats patients suffering from the effects of childhood obesity.

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Norton Healthcare pay the past due sum of \$8,088,399 no later than September 25, 2013, that it pay the \$16,000,000 outstanding balance of the agreed incremental Pediatric Department funding by September 30, 2013 and make pro rata payments on a going forward basis each month thereafter pending the negotiation and execution of a final Master Affiliation Agreement, that it proceed immediately to negotiate with U of L in good faith to conclude such Master Affiliation Agreement and that it permit Medical Staff and a trustee of U of L to attend Board of Director and Executive Committee meetings.

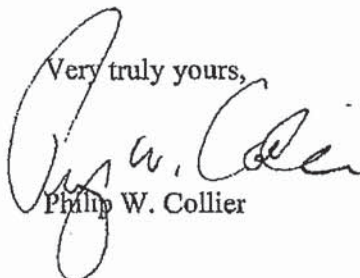
Third, by announcing its *unilateral* intention to enter into definitive and binding agreements that would (a) delegate joint clinical, operational and financial control of the U of L School of Medicine's pediatric teaching hospital to a *different* university with a *different* teaching hospital; (b) use Kosair Children's Hospital in a manner that would restrict, diminish, damage, impair, and threaten the U of L School of Medicine and its Pediatric Department; and (c) delegate joint recruitment, retention and placement of pediatric specialists to a *different* university with a *different* teaching hospital, Norton Healthcare has repudiated its covenant to operate Kosair Children's hospital – a public asset – for the programs and use of the U of L School of Medicine as its pediatric teaching hospital. See Exh. B, *Joint Venture Letter of Intent* dated August, 2013. This covert plan to deprive U of L of its rights under the 1981 Lease was accomplished, in part, by Norton Healthcare's refusal to provide access to Executive Committee Meetings and Board of Directors meetings, which also constitutes a breach of the 1981 Lease, as described above.

This repudiation constitutes a present default and U of L demands that Norton Healthcare immediately – and no later than 30 days from the receipt of this notice – cure the default by providing adequate written assurance that it no longer intends to proceed with its previously announced intention to enter into any binding agreement that would have any or all of the consequences described under the headings (a), (b) or (c) contained in the previous paragraph – or any similar or related consequences.

U of L issues this notification and demand without prejudice to its right to make further demands and claims, including but not limited to claims related to the anticompetitive effect of Norton Healthcare's conduct described herein, and claims for the recovery of expenses, consequential damages, legal fees, punitive damages and other forms of damages.

STITES & HARBISON PLLC
ATTORNEYS

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Very truly yours,

Philip W. Collier

PWC:lcs
w/encl.

cc: Governor Steven L. Beshear (overnight mail)
Attorney General Jack Conway (overnight mail)
Secretary Lori Flanery, Finance & Administration Cabinet (overnight mail)
David L. Dunn, M.D., PhD
Stephen A. Williams, Chief Executive Officer, Norton Healthcare (certified mail)

Exhibit A