

Options for Exiting the Maltese Healthcare Project

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Introduction

This paper seeks to explore, in high level terms, various options open to Steward Health Care Systems, LLC (“**Steward**”) if it decided to exit the Malta healthcare project (which includes the DBFO of hospitals in Malta and the related clinical and non-clinical services pursuant to a PPP structure with the Government of Malta (“**GoM**”) (the “**Concession**”).

Background

In relation to the Concession, Steward initially created a corporate structure which, other than a shareholding in the holding company incorporated in Malta, Steward Health Care International Limited (“**SHCI**”), provided no linkage in contractual or security terms between Steward (in the US) with SHCI and its subsidiaries. The subsidiaries are, for the purposes of the Concession, the Maltese incorporated concession companies namely Steward Malta Limited, Steward Malta Management Limited and Steward Malta Assets Limited (the “**Concession Companies**”).

Save for the “Performance Bond” letter dated 1 June 2018 (which expires on 30 December 2018) and which is accompanied by an assurance from the GoM that they would not call for the bond to be honoured) Steward has not guaranteed the obligations of SHCI or the Concession Companies nor has it provided any other surety or form of security (to our knowledge) to any other third party in Malta including the GoM.

Accordingly, if Steward decided to “detach” SHCI and the Concession Companies, it could do so without any contractual or security linkage.

Possible Options

The options for “exiting” the Concession could, in high level terms, include the following:-

1. an insolvency process in accordance with Maltese law and guidance. Please see headline notes in **Appendix I**.

One thing to bear in mind is that Steward itself is an unsecured creditor of SHCI and the Concession Companies of the Maltese entities [*Note: We understand the amount provided by Steward is circa [\$8 million]*];

2. give back the Concession voluntarily. This could be considered and would require the active involvement and participation of the GoM and should be explored further. The GoM could be approached on the basis that due to their various defaults (as far as Steward see them) under the Concession arrangements, it is not a sustainable operation for Steward to carry on with the Concession. This could also be structured carefully as a “win-win” solution (i.e. the GoM take back the Concession, as some are politically keen to do so, and Steward exit in essentially a no-fault scenario without pursuing a termination payment);
3. create a termination scenario. Steward argues that the GoM is at fault under the Concession agreements. The GoM appears to be in default of its payment obligations and other obligations (**Appendix II**, lists the headline elements here) and accordingly has created the termination scenario.

Please also note **Appendix III (Part 1)** in respect of the procedural elements including the payment of termination sums in the different GoM termination scenarios. **Appendix III (Part 2)** refers to the reverse scenarios, where Steward created or is in default. This process is likely to be a contentious process and is one where the defaulting party (GoM) could potentially rectify the default;

4. there could also be a dealing in the shares held in the Concession Companies, including a sale. Any change of control in the shares of the Concession Companies is time restricted (up to 3 years after the completion date of construction) subject to the consent of GoM (both in contractual and practical terms).

The sale could be to a third party or indeed through or to the existing management by way of a possible MBO (with the support of the GoM) and could be combination of giving the Concession back referred to above. Steward could also continue its involvement in Malta in this scenario by creating a consultancy type arrangement with a lower risk profile.

Issues

The following points need to be considered further:-

1. **Reputational Risk:** this is an important point given that exiting from Malta is likely to have a reputational effect in Malta, which is obviously understood, but potentially also for Steward's other international ventures. We should discuss this aspect further especially where Steward's international ventures may include an arrangement with a government entity either as a direct counterparty or as the ultimate payer. The likely reputational effect on the GoM is more substantial and maybe a ground for them to fight. A potential acquisition would not carry the same risks;
2. **Corporate Structure:** although see points before above. Please also note points made in **Appendix I**;
3. being attacked for "*bad faith*", although again, given where we are with the GoM, this could be something that could be argued against forcefully;
4. McCue & Partners are seeking to attack Steward in the US rather than any of the Maltese enterprises (as Dentons and DFA Associates are). Exiting Malta may not necessarily clear any potential attack in the US, although there is confidence that such attack would, and could, be defended vigorously [*Note: this aspect has been discussed with Steward's GC's office in the US*];
5. as there have been existing discussions with creditors of the Concession Companies and arrangements agreed (pursuant to lengthy negotiations and contractual documents) these may need to be honoured if the contractual obligations arise before Steward exits (e.g. Sam Luft);
6. the Concession Companies would have defaulted on the BoV secured debt arrangements; and
7. [others].

Process Going Forward

In order to implement an exit strategy:-

1. we would suggest a more **detailed due diligence** exercise to consider and cost-out the various options referred to above and the potential exposure to Steward. This may require consultation with a larger Steward Malta team brought into the “**inside team**”;
2. we would want to engage with a competent local **Maltese insolvency practitioner** (ensuring confidentiality, although Malta is a very high risk and “gossipy” environment and therefore the choice of advisor has to be considered carefully);
3. it is important that a robust **public relations strategy** is properly considered and adopted and portrays a situation, if we choose one of the above options, that Steward has been brought to the decision to exit because the GoM is at fault in respect of the matters outlined in **Appendix II** and also the representations that were given verbally at the outset.

In this respect, whilst we have very little by way of contractual or written confirmation, the GoM provided a view at the outset that if Steward took over the Concession Companies by taking over the shares of Bluestone (the previous owner of the Concession Companies), the GoM would help in the process of allowing Steward:-

- (i) to conduct a proper due diligence on the Concession after the sale of shares was completed;
- (ii) to amend the project documentation to make it more “bankable”;
- (iii) to make up any deficiencies (i.e. creditors paid or debts due) through an enhanced annual charge and also to assist in the process with the Unions and creditors generally, etc. It is arguable whether the GoM has fulfilled its side of the bargain in this respect.

APPENDIX 1

(Headline Insolvency Procedures in Malta – requires further consideration)

Insolvency procedures

- Court winding up: upon application to the court by creditors or the company.
- Members' voluntary winding up: the company must pass a resolution for dissolution and consequential voluntary winding up and the company directors may make a declaration that the company will be able to pay its debts in full within 12 months of the date of dissolution. If the directors do not make such a declaration, the winding up will be treated as a creditors' voluntary winding up.
- a creditors' voluntary winding up: will apply in the abovementioned scenario.

Directors and parent company liability

Fraudulent trading

- Fraudulent trading arises if, in the course of winding up a company, it appears that the business of the company has been carried out with the intention to defraud creditors of the company or creditors of any other person, or for any other fraudulent purpose.
- Court can impose liability on any person, including directors, shareholders or any other persons knowingly involved in the fraud with no limitation for all or any of the debts or other liabilities of the company.

Wrongful trading

- Directors of a company which goes into an insolvent liquidation may be ordered to make a payment towards the company's assets, as the court sees fit.
- Wrongful trading arises where "a director of the company knew, or ought to have known prior to the dissolution of the company that there was no reasonable prospect that the company would avoid being dissolved due to its insolvency".

Others

- Certain laws, such as the Income Tax Management Act in Malta, also impose personal liability on directors for certain debts which would in the normal course be due and payable by the company.

Parent company liability

- The general principle is that the holding company is not liable for the acts of its subsidiaries.
- However, there may be instances in which a holding company will incur liability on the basis of general principles of law and independently of the fact that a holding-subsidiary relationship exists including (but not limited to) situations of:

- agency;
- liability in tort; and
- the grant of a guarantee by a holding company in favour of the creditors of the subsidiary.

Effect on existing contracts

- Existing contracts cannot be enforced during liquidation procedures for an insolvent company (i.e. tantamount to an administration type arrangement).

Typical timeframe for completion of liquidation procedures

- voluntary winding up: typically takes 12 to 16 months
- court winding up: possibly up to 3 years

Director and shareholder involvement

- All powers of the directors and officers of the company cease on the appointment of a liquidator.
- Shareholders have little involvement in an insolvent winding up, beyond participation in the meetings called by the liquidator.

Transaction avoidance

- Fraudulent preference transactions incurred by the company within the 6 months preceding the company's dissolution.

Employees

- Employers must establish a guarantee fund with the aim of guaranteeing payment of unpaid wages owed to employees.
- Wages are privileged debts to be paid in preference to all other claims up to a cap.
- Redundancy regulations apply.

Appendix II

(Headline elements leading to the GoM events of default under the Concession Agreements)

See paper from Armin Ernst

**Appendix III
(Part 1)**

(Summary of provision in the Concession Agreements and termination payments (the GoM to Steward))

Relevant GoM Termination Events (Steward right to terminate and exit)	Process and Cure Period	GoM Termination Payments
<p><u>Services Concession Agreement (SCA)</u></p> <ul style="list-style-type: none"> a. Discretionary GoM Termination b. GoM non-payment of HSDA Charges c. GoM non-compliance with the SCA and other concession agreements d. GoM not to molest, interfere etc of the Concessionaire e. GoM failure to grant vacant site possession f. GoM breach of other SCA obligations or other concession agreement obligations 	<ul style="list-style-type: none"> a. GoM can exercise this discretionary termination right by giving a 120-day notice b. 45 days cure period following 30-day credit period reminder notices every 15 days send a formal default notice send a formal termination notice c. Items (c) to (e) must have a MAE on the Steward Group for 90 continuous days potential extension of further 90 days send a formal default notice send a formal termination notice f. 90 day cure period Termination subject to a formal rectification process send a formal default notice send a formal rectification notice send a formal termination notice 	<p>Lender's Debt <i>plus</i> EUR 100 million</p>
<p><u>Health Services delivery Agreement (HSDA)</u></p> <ul style="list-style-type: none"> a. Same as SCA above 	<ul style="list-style-type: none"> a. Same as SCA above 	<p>As per the SCA above</p>
<p><u>Labour Services Agreement (LSA)</u></p> <ul style="list-style-type: none"> a. Automatically terminates with the SCA b. GoM breach of the material terms and conditions 	<ul style="list-style-type: none"> b. 30-day cure period send a formal default notice send a formal termination notice 	
<p><u>Emphyteutical Deed (ED)</u></p> <ul style="list-style-type: none"> a. Breach of GoM entity ED obligations 	<ul style="list-style-type: none"> a. No prescribed cure period send a formal default notice send a formal termination notice 	<p>None prescribed</p>

Notes

- Default notice and termination notice process not clearly prescribed in all cases but should be followed as a matter of best practice
- Steward excused from its performance obligations during a GoM default event
- A formal handback process applies upon termination e.g. handover of Sites, assets, business, contracts, rights, information etc.
- Separate process and consequences apply for Steward default and termination events

(Part 2)
(Potential events of default of Steward)

Services Concession Agreement

EVENTS OF DEFAULT AND	
CATEGORY	CONSEQUENCES
Non-Rectifiable Steward Event of Default	<p>Events</p> <ul style="list-style-type: none">• Fraudulently or willfully carrying out any licensed or regulated entity without being duly licensed• Breach of the Licence terms• Abandonment without GoM consent• Insolvency events <p>Consequences</p> <ul style="list-style-type: none">• GoM entitled to terminate the SCA and other Transaction Agreements• GoM entitled to call on the Performance Guarantee / New Performance Guarantee• GoM to pay outstanding Lenders' Debt
Rectifiable Steward Event of Default	<p>Events</p> <ul style="list-style-type: none">• Non-observance of any of its SCA obligations (other than the Non-Rectifiable VGH Group Event of Default) <p>Consequences</p> <ul style="list-style-type: none">• GoM to serve a Rectification Notice• Steward to submit a 60-90 days Rectification Programme acceptable to GoM

EVENTS OF DEFAULT AND	
CATEGORY	CONSEQUENCES
	<ul style="list-style-type: none">• Steward Group failure to rectify as per the Rectification Notice and the Rectification Programme triggers GoM Step-In