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Audited Financial Statements

DECEMBER 31, 2010



Sutter Health and Affiliates

Combined Financial Statements

Year ended December 31, 2010 and 2009

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Report of Independent Auditors

The Board of Directors
Sutter Health and Affiliates

We have audited the accompanying combined balance sheets of Sutter Health and Affiliates as of December 31, 2010 and 2009, and the related combined statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Sutter Health and Affiliates' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of Sutter Health and Affiliates' internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Sutter Health and Affiliates' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Sutter Health and Affiliates at December 31, 2010 and 2009, and the combined results of their operations and changes in their net assets, and their cash flows for the years then ended in conformity with United States generally accepted accounting principles.

Ernst & Young LLP

March 22, 2011

Sutter Health and Affiliates

Combined Balance Sheets

(Dollars in millions)

	December 31,	
	2010	2009
	<i>(As Adjusted)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 356	\$ 388
Short-term investments	2,167	1,473
Patient accounts receivable (net of allowance for doubtful accounts of \$277 in 2010 and \$228 in 2009)	1,058	1,024
Other receivables	244	167
Securities lending receivable	172	170
Inventories	89	92
Other	68	66
Total current assets	4,154	3,380
Non-current investments	939	1,145
Property, plant and equipment, net	5,227	4,799
Other	473	387
	\$ 10,793	\$ 9,711
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 261	\$ 223
Accrued salaries and related benefits	472	433
Other accrued expenses	419	403
Securities lending collateral payable	176	176
Current portion of long-term obligations	71	63
Total current liabilities	1,399	1,298
Non-current liabilities:		
Long-term obligations, less current portion	2,422	2,490
Other	639	568
Net assets:		
Unrestricted controlling	5,950	5,002
Unrestricted noncontrolling	41	36
Temporarily restricted	225	204
Permanently restricted	117	113
	6,333	5,355
	\$ 10,793	\$ 9,711

See accompanying notes.

Sutter Health and Affiliates

Combined Statements of Operations and Changes in Net Assets

(Dollars in millions)

	Year ended December 31,	
	2010	2009
	<i>(As Adjusted)</i>	
Unrestricted net assets:		
Operating revenues:		
Patient service revenues	\$ 7,858	\$ 7,129
Capitation revenues	940	1,019
Contributions	10	10
Other	308	336
Total operating revenues	9,116	8,494
Operating expenses:		
Salaries and employee benefits	4,001	3,888
Purchased services	1,716	1,698
Supplies	968	919
Depreciation and amortization	424	427
Capitated purchased services	216	242
Provision for doubtful accounts	332	316
Rentals and leases	124	117
Interest	67	75
Insurance	25	35
Other	558	306
Total operating expenses	8,431	8,023
Income from operations	685	471
Investment income	124	11
Change in net unrealized gains and losses on investments classified as trading	112	233
Income	921	715
Less income attributable to noncontrolling interests	(43)	(38)
Income attributable to Sutter Health	878	677

Sutter Health and Affiliates

Combined Statements of Operations and Changes in Net Assets (continued)

(Dollars in millions)

	Year ended December 31,	
	2010	2009
	<i>(As Adjusted)</i>	
Unrestricted net assets (continued):		
Unrestricted controlling net assets:		
Income attributable to Sutter Health	\$ 878	\$ 677
Change in net unrealized gains and losses on investments classified as other-than-trading	3	23
Net assets released from restrictions for equipment acquisition	9	14
Donated long-lived assets	2	1
Pension-related changes other than net periodic pension cost	35	285
Transfers with unrelated entities, net	16	28
Other	5	(12)
Increase in unrestricted controlling net assets	948	1,016
Unrestricted noncontrolling net assets:		
Income attributable to noncontrolling interests	43	38
Distributions	(40)	(35)
Contributed capital	2	1
Increase in unrestricted noncontrolling net assets	5	4
Temporarily restricted net assets:		
Contributions	40	33
Investment income	7	4
Change in net unrealized gains and losses on investments	10	27
Net assets released from restrictions	(35)	(44)
Other	(1)	2
Increase in temporarily restricted net assets	21	22
Permanently restricted net assets:		
Contributions	3	7
Investment income	1	-
Change in net unrealized gains and losses on investments	1	3
Other	(1)	5
Increase in permanently restricted net assets	4	15
Increase in net assets	978	1,057
Net assets, beginning of year	5,355	4,298
Net assets, end of year	\$ 6,333	\$ 5,355

See accompanying notes.

Sutter Health and Affiliates

Combined Statements of Cash Flows

(Dollars in millions)

	Year ended December 31,	
	2010	2009
	<i>(As Adjusted)</i>	
Operating activities		
Increase in net assets	\$ 978	\$ 1,057
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	408	420
Amortization of bond issuance costs and discount (premium)	(3)	(3)
Change in net unrealized gains and losses on investments	(126)	(286)
Provision for doubtful accounts	332	316
Restricted contributions and investment income	(25)	(14)
Loss on impairment of property, plant and equipment	16	7
Loss on disposal of property, plant and equipment	1	6
Net changes in operating assets and liabilities:		
Patient accounts receivable and other receivables	(445)	(430)
Inventories and other assets	(86)	(128)
Accounts payable and accrued expenses	93	46
Other non-current liabilities	71	50
Net cash provided by operating activities	1,214	1,041
Investing activities		
Purchases of property, plant and equipment	(851)	(833)
Proceeds from disposal of property, plant and equipment	1	1
(Purchases) and sales or maturities of investments, net	(362)	147
Other	(2)	1
Net cash used in investing activities	(1,214)	(684)

Sutter Health and Affiliates

Combined Statements of Cash Flows (continued)

(Dollars in millions)

	Year ended December 31,	
	2010	2009
	<i>(As Adjusted)</i>	
Financing activities		
Proceeds from borrowings on line of credit	\$ —	\$ 742
Payments on line of credit	—	(1,134)
Payments of long-term obligations	(28)	(29)
Payments for bond redemption	(39)	—
Proceeds from issuance of long-term obligations	10	8
Net proceeds from restricted contributions and investment income	25	14
Net cash used in financing activities	(32)	(399)
Net decrease in cash and cash equivalents	(32)	(42)
Cash and cash equivalents at beginning of year	388	430
Cash and cash equivalents at end of year	\$ 356	\$ 388
 Supplementary disclosures of cash flow information:		
Cash paid during the year for interest (net of capitalized interest costs of \$58 in 2010 and \$57 in 2009)	\$ 68	\$ 76

See accompanying notes.

Sutter Health and Affiliates

Notes to Combined Financial Statements

December 31, 2010 and 2009

(Dollars in millions)

1. ORGANIZATION

Sutter Health is a California not-for-profit multi-provider integrated health care delivery system headquartered in Sacramento, California, which includes a centralized support group and various health care-related businesses operating primarily in five geographic regions, principally in Northern California. Sutter Health and its affiliates and subsidiaries provide health care, education, research and administration services.

The five geographic regions include acute care and psychiatric hospitals, skilled nursing facilities, medical foundations, fundraising foundations and a variety of other specialized health care service providers. These entities are commonly referred to as the Affiliates. Most acute care hospitals provide a full range of medical services (e.g., surgical, intensive care, emergency room, and obstetrics). All emergency rooms provide emergency care, regardless of a patient's ability to pay. Sutter Health and its Affiliates also serve their communities with programs including health education, health libraries, school-based clinics, home health care, hospice care, adult day care, prenatal clinics, community clinics, immunization services, and training health professionals.

2. ACCOUNTING POLICIES

Basis of Combination: The combined financial statements include the accounts of Sutter Health and its controlled affiliates and subsidiaries (Sutter). All significant intercompany accounts and transactions have been eliminated in combination.

Change in Reporting Entity: In June 2010, Sutter resigned as the sole corporate member of Marin General Hospital (MGH), a California nonprofit public benefit corporation, and no longer controls the activities and affairs of MGH. The replacement of Sutter as the sole corporate member has been accounted for as a change in reporting entity; therefore, the 2009 and 2010 combined financial statements have been adjusted to exclude the financial position and activities of MGH, excluding certain other reclassifications. The impact of these changes for the year ended December 31, 2009 is as follows:

	As Previously Reported	As Adjusted
Assets	\$ 9,810	\$ 9,700
Revenues	8,772	8,504
Income	697	677
Net assets	5,385	5,319

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Use of Estimates: The preparation of financial statements in conformity with United States (U.S.) generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the combined financial statements and accompanying notes. Actual results could differ from those estimates.

Cash Equivalents: Cash equivalents include all highly liquid investments with original maturities of 90 days or less, including money market accounts with limited market risk. Financial instruments that potentially subject Sutter to concentrations of credit risk include cash equivalents and investments. Sutter places certain of its cash in banks that are federally insured in limited amounts and in investment-grade debt instruments, many of which are backed by the U.S. Government or other government agencies. Cash equivalents are stated at fair market value.

Investments: Investments consist principally of corporate debt and equity securities, U.S. Government and agency securities, and foreign government and corporate debt securities, all of which are designated as either trading or other-than-trading and carried at fair market value. Certain investments are held in trust. These include assets held by trustees in accordance with the indentures relating to long-term obligations. In addition, certain investments are designated by the appropriate Sutter governing boards for future capital improvements.

Patient Accounts Receivable: Sutter's primary concentration of credit risk is patient accounts receivable, which consist of amounts owed by various governmental agencies, insurance companies and private patients. Sutter manages the receivables by regularly reviewing its patient accounts and contracts and by providing appropriate allowances for uncollectible amounts. Significant concentrations of gross patient accounts receivable are as follows:

	December 31,	
	2010	2009
Medicare	28%	27%
Medi-Cal	20%	20%

During 2010 and 2009, certain affiliates collected on accounts that were previously deemed uncollectible and reserved. Such recoveries are recognized in the period that cash is received and were not material. Due to the inherent variability in this area of patient receivable collections, there is at least a reasonable possibility that recorded estimates may change by a material amount in the near term.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Securities Lending: Sutter participates in securities lending transactions with its custodian whereby Sutter lends a portion of its investments to various brokers in exchange for collateral for the securities loaned, usually on a short-term basis. Collateral provided by brokers consists of cash and cash equivalents and is maintained at levels of at least 100% of the fair value of the securities on loan and is subject to market fluctuations. Sutter maintains effective control of the loaned securities through its custodian during the term of the arrangement in that they may be recalled at any time. Under the terms of the agreement, the borrower must return the same, or substantially the same, investments that were borrowed. The market value of loaned securities is reported as a securities lending receivable, and a corresponding obligation is reported for repayment of related collateral upon settlement of the lending transaction. At December 31, 2010 and 2009, the market value of the securities on loan was \$172 and \$170, respectively. At January 31, 2011, management suspended its participation in the program.

Inventories: Inventories, which consist principally of medical and other supplies, are stated on the basis of cost determined by the first-in, first-out method, which is not in excess of market.

Property, Plant and Equipment: Property, plant and equipment are stated on the basis of cost, or in the case of donated items, on the basis of fair market value at the date of donation, less depreciation and any impairment write-downs. Equipment includes medical equipment, furniture and fixtures, software, and internally-developed software. Routine maintenance and repairs are charged to expense as incurred. Expenditures that increase values, change capacities or extend useful lives are capitalized, as is interest on amounts borrowed to finance constructed assets.

Depreciation is computed by the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years for buildings and improvements and leasehold improvements and from 3 to 20 years for equipment. Amortization of equipment under capital leases is included in depreciation and amortization expense.

Asset Impairment: Sutter routinely evaluates the carrying value of its long-lived assets for impairment. The evaluations address the estimated recoverability of the assets' carrying value, which is principally determined based on projected net cash flows generated by the underlying tangible assets. When the carrying value of an asset exceeds estimated recoverability, asset impairment is recognized.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Other Assets: Goodwill represents the excess of purchase price over the fair market value of net assets acquired. Goodwill and other intangible assets acquired in purchase business combinations and determined to have indefinite useful lives are not amortized, but instead are subject to impairment tests. Sutter performs impairment tests at the reporting unit level when events occur that require an evaluation to be performed or at least annually. If the carrying value of goodwill is determined to be impaired, or if the carrying value of a business that is to be sold or otherwise disposed of exceeds its fair value, then the carrying value is reduced, including any allocated goodwill, to fair value. Estimates of fair value are based on appraisals, established market prices for comparative assets or internal estimates of future net cash flows based on projected performance, depending on circumstances. There were no material changes in goodwill in 2010 or 2009.

Unamortized financing costs associated with the issuance of long-term bonds are amortized ratably over the estimated average period the bonds will be outstanding.

Other Liabilities: Other non-current liabilities consist of (i) insurance liabilities, including estimated liabilities for professional liability losses and workers' compensation, (ii) the portion of estimated third-party settlements not expected to be settled within a year, (iii) other postretirement benefits liabilities, and (iv) certain other liabilities.

Risk Management: Sutter is self-insured for workers' compensation and employee health for most affiliates. Also, affiliates are insured by a wholly owned self-insured captive insurance company for professional liability claims and comprehensive general liability. The provisions for estimated workers' compensation, employee health, and professional liability and comprehensive general liability claims include estimates of the ultimate costs for both uninsured reported claims and claims incurred-but-not-reported (IBNR), in accordance with actuarial projections or paid claims lag models based on past experience. Such claim reserves are based on the best data available to Sutter; however, these estimates are subject to a significant degree of inherent variability. Accordingly, there is at least a reasonable possibility that a material change to the estimated reserves will occur in the near term. Such estimates are continually monitored and reviewed, and as reserves are adjusted, the differences are reflected in current operations. While the ultimate amount of workers' compensation, employee health, and professional liability and comprehensive general liability claims is dependent on future developments, management is of the opinion that the associated liabilities recognized in the accompanying combined financial statements are adequate to cover such claims.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Sutter has entered into reinsurance, stop loss, and excess policy agreements with independent insurance companies to limit its losses on workers' compensation, employee health, professional liability and comprehensive general liability claims.

Workers' compensation liabilities were \$155 and \$144 discounted using a rate of 3.0% and 3.7%, as of December 31, 2010 and 2009, respectively. Sutter has other workers' compensation plans administered at certain affiliates that are discounted using rates ranging from 2.4% to 3.0% and 3.7% to 5.0%, as of December 31, 2010 and 2009, respectively, with reserves amounting to \$43 and \$43, respectively. Employee health liabilities were \$43 and \$38, and were recorded on an undiscounted basis in accrued salaries and related benefits. Professional liabilities were \$104 and \$94 discounted at a rate of 1.6% and 2.6% as of December 31, 2010 and 2009, respectively. Management is not aware of any potential professional liability claims whose settlement would have a material adverse effect on Sutter's combined financial position.

In lieu of a security deposit requirement, most of Sutter's self-insured workers' compensation plans paid assessment charges to participate in California Self Insurers' Alternative Security Program, which provided coverage of \$105 and \$103 as of December 31, 2010 and 2009, respectively.

Asset Retirement Obligations: Sutter has recorded an estimated liability of \$54 and \$56 at December 31, 2010 and 2009, respectively, related to the fair value of costs for asbestos abatement that will result from Sutter's current plans to renovate and/or demolish certain acute care facilities.

Contingencies: Estimated losses from contingencies are recorded when they are probable and reasonably estimable.

Net Assets: Net resources that are not restricted by donors are included in unrestricted net assets. Gifts of long-lived operating assets, such as property, plant or equipment, are reported as unrestricted net assets and excluded from income. Resources restricted by donors for a specified time or purpose are reported as temporarily restricted net assets. When the specific purposes are achieved, either through passage of a stipulated time period or when the purpose for restriction is accomplished, they are released to other operating revenues in the combined statement of operations and changes in net assets. Resources temporarily restricted by donors for additions to property, plant and equipment are initially reported as temporarily restricted net assets and are transferred to unrestricted net assets when expended. Donor-imposed restrictions, which stipulate that the resources be maintained permanently, are reported as permanently restricted net assets.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Investment income related to temporarily or permanently restricted net assets is classified as either temporarily restricted or unrestricted based on the intent of the donor, or is added to permanently restricted net assets if required by the donor.

Patient Service Revenues: Patient service revenues are reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement programs with third-party payers. Estimated settlements under third-party reimbursement programs are accrued in the period the related services are rendered and adjusted in future periods, primarily as a result of final cost report settlements with government agencies.

Purchased Services: Purchased services expense is made up of a wide variety of contracted and other purchased services, including medical group compensation, other professional fees, and repairs and maintenance. Medical group compensation is accrued by Sutter according to professional services agreements between affiliated medical foundations and their contracted medical groups.

Capitated Services: Sutter has agreements with various Health Maintenance Organizations (HMOs) to provide medical services to subscribing participants. Under these agreements, Sutter receives monthly capitation payments based on the number of each HMO's participants that are covered by the contract, regardless of services provided by Sutter. Certain of these agreements also contain provisions whereby additional amounts may be due or paid. Sutter accrues costs for out-of-area services when services are rendered under these contracts, including estimates of IBNR claims and amounts receivable/payable under risk-sharing arrangements. The IBNR accrual is an estimate of the cost of services for which Sutter is responsible.

Advertising: Sutter expenses advertising costs as incurred. Advertising expense (included in other operating expenses) was \$19 in 2010 and \$19 in 2009.

Research and Development: Sutter expenses research and development costs as incurred. Research and development expense (included in other operating expenses) was \$44 in 2010 and \$46 in 2009.

Income Taxes: Sutter Health and most affiliates have been determined to be exempt organizations by the Internal Revenue Service, (pursuant to Internal Revenue Code Section 501(c) (3)), and the California Franchise Tax Board (pursuant to California Revenue and Taxation Code 23701(d)) and, generally, are not subject to taxes on income.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Certain activities of Sutter are subject to income taxes; however, such activities are not significant to the combined financial statements. With respect to its for-profit subsidiaries and taxable activities, Sutter records income taxes using the liability method under which deferred tax assets and liabilities are determined based on the differences between the financial accounting and tax bases of assets and liabilities. Deferred tax assets or liabilities at the end of each period are determined using the currently enacted tax rate expected to apply to taxable income in the periods that the deferred tax asset or liability is expected to be realized or settled.

Performance Indicator: “Income” as reflected in the accompanying combined statements of operations and changes in net assets is a performance indicator. Income includes changes in unrestricted net assets other than contributions of long-lived assets, changes in net unrealized gains and losses on investments classified as other-than-trading, retirement plans and post-retirement benefits actuarial gains and losses and prior service costs, discontinued operations, cumulative effects of changes in accounting principles and extraordinary items.

Adoption of New Accounting Pronouncements: In April 2009, the Financial Accounting Standards Board (FASB) issued SFAS 164, *Not-for-Profit Entities: Mergers and Acquisitions, including an amendment of FASB Statement 142*, as codified by Accounting Standards Update (ASU) No. 2010-07, *Not for Profit Entities*, Accounting Standards Codification (ASC) 958. This statement provides guidance on accounting for a combination of not-for-profit entities and applies to a combination that meets the definition of either a merger of not-for-profit entities or an acquisition by a not-for-profit entity. ASU 2010-07 establishes principles and requirements for how a not-for-profit entity (a) determines whether a combination is a merger or acquisition, (b) applies the carryover method in accounting for a merger, (c) applies the acquisition method in accounting for an acquisition, and (d) determines what information to disclose with respect to the nature and financial effects of a merger or an acquisition. This statement also amends SFAS No. 142, *Goodwill and Other Intangible Assets* and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* to make their provisions fully applicable to not-for-profit entities. The provisions of ASU 2010-07, which are to be applied prospectively for business combinations and goodwill and other intangible assets, were effective for Sutter January 1, 2010, and the adoption of this guidance did not have a material impact on the combined financial position, results of operations, or cash flows. The provisions for noncontrolling interests, which were effective for Sutter January 1, 2010, had no impact on the financial condition, results of operations or cash flows. However, noncontrolling interests in subsidiaries are now presented as a separate

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

component of unrestricted net assets in the combined statement of operations and changes in net assets. Certain prior-year amounts have been reclassified to conform to the current-year presentation required by this guidance.

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures about Fair Value Measurement*, which amended ASC 820, *Fair Value Measurements and Disclosures*, to require new disclosures related to transfers in and out of Level 1 and 2 fair value measurements, including reasons for the transfers, and to require new disclosures related to activity in Level 3 fair value measurements. In addition, ASU 2010-06 clarifies existing disclosure requirements related to the level of disaggregation of classes of assets and liabilities, and provides further detail about inputs and valuation techniques used for fair value measurement. Sutter adopted ASU 2010-06 effective January 1, 2010, and the adoption did not have a material impact on the combined financial condition, results of operations, or cash flows.

In February 2010, the FASB issued ASU No. 2010-09, *Subsequent Events: Amendments to Certain Recognition and Disclosure Requirements*, which amended ASC 855, *Subsequent Events*, requiring the evaluation of subsequent events through the date that the financial statements are issued. Sutter adopted ASU 2010-09 effective January 1, 2010, and the adoption of this guidance did not have a material impact on Sutter's combined financial condition, results of operations, or cash flows.

In August 2010, the FASB issued ASU No. 2010-23, *Health Care Entities, ASC 954, Measuring Charity Care for Disclosures*, which requires that cost be used as a measurement for charity care disclosure purposes and that cost can be identified as the direct and indirect costs of providing the charity care. It also requires disclosure of the method used to identify or determine such costs. Management is currently evaluating the potential impact of this guidance, which will be effective January 1, 2011, but does not expect it to have a material impact on the combined financial condition, results of operations, or cash flows.

In August 2010, the FASB issued ASU No. 2010-24, *Health Care Entities, ASC 954, Presentation of Insurance Claims and Related Insurance Recoveries*, which clarifies that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. Management is currently evaluating the potential impact of this guidance, which will be effective January 1, 2011, but does not expect it to have a material impact on the combined financial condition, results of operations, or cash flows.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Reclassifications: Certain amounts in Sutter's 2009 combined financial statements have been reclassified to conform with the presentation of its 2010 combined financial statements. These reclassifications had no impact on previously reported income or net assets.

3. INVESTMENTS

Investments are held for the following uses:

	December 31,	
	2010	2009
Assets held in trust:		
Principal, interest and other reserves held in trust under bond indentures	\$ 244	\$ 394
Internally designated Investments	593	624
	2,269	1,600
	3,106	2,618
Less short-term investments	(2,167)	(1,473)
Non-current investments	\$ 939	\$ 1,145

Investment income includes the following:

	Year ended December 31,	
	2010	2009
Interest and dividends	\$ 71	\$ 66
Investment fees	(9)	(9)
Net realized gain (loss) on sales of securities, including net loss from other-than-temporary impairment	95	(16)
	157	41
Amounts included in changes in restricted net assets	(8)	(4)
Interest earned on unspent bond project funds	(25)	(26)
Investment income	\$ 124	\$ 11

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

3. INVESTMENTS (continued)

Sutter uses the specific-identification method to compute realized gains and losses on U.S. and foreign equity securities, U.S. Government and agency securities, U.S. corporate debt securities, and foreign government and corporate debt securities. Sutter uses the average cost method to compute realized gains and losses on mutual funds. Marketable equity securities, which include stocks and mutual funds, are primarily held for endowments, future capital improvements, and investment diversification.

4. FAIR VALUE MEASUREMENTS

Sutter accounts for certain assets and liabilities at fair value. A fair value hierarchy for valuation inputs has been established to prioritize the valuation inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels, which is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the measurement date.

Level 2: Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve judgment and interpretations including, but not limited to, private and public comparables, third party appraisals, discounted cash flow models, fund manager estimates and net asset valuations provided by the underlying private investment companies and/or their administrators.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

The fair value of Sutter's assets and liabilities measured on a recurring basis consist of the following:

	December 31, 2010			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance at December 31, 2010
Liquid investments				
Cash equivalents	\$ 310	\$ –	\$ –	\$ 310
Equity securities				
U.S. equity securities	532	48	–	580
Foreign equity securities	287	22	–	309
Fixed income securities				
U.S. government securities	76	–	–	76
U.S. government agencies securities	25	95	–	120
U.S. state and local government securities	–	65	–	65
U.S. federal agency mortgage-backed securities	–	298	–	298
Foreign government securities	–	400	–	400
U.S. corporate securities	75	639	–	714
Foreign corporate securities	–	127	–	127
Other investments				
Multi-strategy hedge funds	–	–	53	53
Commodity linked funds	41	–	13	54
	<u>\$ 1,346</u>	<u>\$ 1,694</u>	<u>\$ 66</u>	<u>\$ 3,106</u>

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

	December 31, 2009			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance at December 31, 2009
Liquid investments				
Cash equivalents	\$ 373	\$ –	\$ –	\$ 373
Equity securities				
U.S. equity securities	419	43	–	462
Foreign equity securities	214	23	–	237
Fixed income securities				
U.S. government securities	71	–	–	71
U.S. government agencies securities	23	106	–	129
U.S. state and local government securities	–	56	–	56
U.S. federal agency mortgage-backed securities	–	414	–	414
Foreign government securities	–	259	–	259
U.S. corporate securities	43	448	–	491
Foreign corporate securities	–	63	–	63
Other investments				
Multi-strategy hedge funds	–	–	52	52
Commodity linked funds	–	–	11	11
	\$ 1,143	\$ 1,412	\$ 63	\$ 2,618

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

There were no significant transfers to or from Levels 1, 2, or 3 during the years presented.

As of December 31, 2010, the Level 2 and 3 instruments listed in the fair value hierarchy table above use the following valuation techniques and inputs:

U.S. and Foreign Equity Securities: The fair value of the U.S. and foreign equity securities classified as Level 2 is primarily determined using the calculated net asset value per share (NAV). These are primarily commingled funds that invest in domestic and foreign equity securities, whose underlying values are based on Level 1 inputs. The fund managers receive prices from nationally recognized pricing services based on observable market transactions.

U.S. Government Agency Securities: The fair value of investments in U.S. government agency securities classified as Level 2 is primarily determined using consensus pricing methods of observable market-based data. Significant observable inputs include quotes, spreads, and data points for yield curves.

Foreign Government Securities: The fair value of investments in foreign government securities classified as Level 2 is primarily determined using discounted cash flow models, incorporating option-adjusted spread (OAS) features as appropriate. In the OAS and non-OAS pricing models, critical inputs include benchmark curves and spread parameters, and issue-specific factors.

U.S. Federal Agency Mortgage-backed Securities: The fair value of U.S. federal agency mortgage-backed securities classified as Level 2 is primarily determined using matrices. These matrices utilize observable market data of bonds with similar features, prepayment speeds, credit ratings, and discounted cash flows. Additionally, observed market movements, tranche cash flows and benchmark yields are incorporated in the pricing models.

U.S. State and Local Government Securities: The fair value of U.S. state and local government securities classified as Level 2 is determined using a market approach. The inputs utilized included yield benchmark curves, prepayment speeds, and observable market data such as institutional bids, dealer quotes, and two-sided markets.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

U.S. and Foreign Corporate Securities: The fair value of the investment in U.S. and foreign corporate bonds classified as Level 2 is primarily determined using techniques that are consistent with the market approach. Significant observable inputs include reported trades, dealer quotes, security specific characteristics, and multiple sources of spread data points in developing yield curves.

Private Equity and Hedge Fund Investments: The fair value of private equity and hedge fund investments classified as Level 3 is determined using the calculated NAV. The values for underlying investments are fair value estimates determined either internally or by an external fund manager based on recent filings, operating results, balance sheet stability, growth and other business and market sector fundamentals. Due to the significant unobservable inputs present in these valuations, Sutter classifies all such investments as Level 3.

The change in the balance of Level 3 financial assets and liabilities measured on a recurring basis consists of the following:

	Multi-Strategy Hedge Funds	Commodity Linked Funds	Total
Balance at January 1, 2009	\$ 20	\$ 5	\$ 25
Total net realized and unrealized gains, included in earnings	7	1	8
Purchases, issuances, and settlements, net	25	5	30
Balance at December 31, 2009	52	11	63
Total net realized and unrealized gains, included in earnings	4	2	6
Purchases, issuances, and settlements, net	(3)	–	(3)
Balance at December 31, 2010	\$ 53	\$ 13	\$ 66
Change in unrealized gains on investments held as of December 31, 2009	\$ 7	\$ 1	\$ 8
Change in unrealized gains on investments held as of December 31, 2010	\$ 4	\$ 2	\$ 6

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

Certain of the investments above report fair value using a calculated NAV or its equivalent. The following table and explanations identify attributes relating to the nature and risk of such investments:

December 31, 2010					
	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period (if currently eligible)	
Level 2					
Commingled funds – equity securities	\$ 70	\$ –	Daily, Monthly, Quarterly	3-60 days	
Commingled funds – debt securities	50	–	Weekly, Monthly	0 -10 days	
Total Level 2	120	–			
Level 3					
Multi-strategy hedge funds	53	–	Quarterly	60-65 days	
Private equity funds	–	5			
Commodity linked funds	13	–	Monthly	5 days	
Total Level 3	66	5			
Total Level 2 and Level 3	\$ 186	\$ 5			

Commingled Funds – Equity Securities: This class includes investments in commingled funds that invest primarily in domestic or foreign equity securities and attempt to match the returns of specific equity indices. A redemption limitation of 10% quarterly gate withdrawals with 60 days notice has been imposed for investments representing approximately 34% of the value of this class. Approximately 54% of the value of this class is redeemable monthly, with a notice period of 6 to 30 days. Other investments representing approximately 12% of this class are redeemable daily with three days notice.

Commingled Funds – Debt Securities: This class includes investments in commingled funds that invest primarily in foreign and domestic debt and fixed income securities, of which the majority are traded in over-the-counter markets. Approximately 89% of these funds are redeemable weekly and the remaining 11% of the funds are redeemable monthly with 10 days notice.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

4. FAIR VALUE MEASUREMENTS (continued)

Multi-Strategy Hedge Funds: This class includes investments in hedge funds that pursue diversification of both domestic and foreign fixed income and equity securities through multiple investment strategies. The primary objective for these funds is to maximize returns while limiting volatility by allocating capital to external portfolio managers selected for expertise in one or more investment strategies which may include, but are not limited to, long/short equity, event driven, relative value, and global asset allocation. A redemption limitation has been imposed for investments representing approximately 56% of the value of this class and no withdrawals are currently permitted. These funds have a three-year lock-up, and 52% of the funds will be available for withdrawal at December 31, 2011 with the remaining 48% becoming available by September 30, 2012, with 60 days written notice. The remaining 44% of the value of the multi-strategy hedge funds is available for redemption with a notice period of 65 days.

Private Equity Funds: This class includes private equity funds that specialize in providing capital to a variety of investment groups, including but not limited to venture capital, leveraged buyout, mezzanine debt, distressed debt, and other strategies, which may include land, water processing, and alternative energy. There is no provision for redemptions during the life of these funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated over the next 3 to 15 years.

Commodity Linked Funds: This class includes commodity linked funds that pursue long-only fully collateralized commodity futures strategies to provide diversification and inflation protection. These funds are redeemable monthly with five days notice before month end.

The investments included above are not expected to be sold at amounts that are different from NAV.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	December 31,	
	2010	2009
Land improvements	\$ 90	\$ 87
Leasehold improvements	179	158
Buildings and improvements	3,829	3,454
Equipment	2,467	2,349
	6,565	6,048
Less amortization and accumulated depreciation	(3,606)	(3,267)
	2,959	2,781
Land	582	569
Construction-in-progress	1,686	1,449
	\$ 5,227	\$ 4,799

6. OTHER ASSETS

Other assets consist of the following:

	December 31,	
	2010	2009
Reinsurance recoveries receivable	\$ 50	\$ 44
Cost report settlements	45	40
Non-current portion of notes receivable	40	39
Non-current portion of pledges receivable	37	35
Goodwill, net	29	29
Unamortized financing costs	12	14
Prepaid pension asset	170	107
Trust receivable	52	41
Other	38	38
	\$ 473	\$ 387

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

7. LONG-TERM OBLIGATIONS

Long-term obligations consist of the following:

	December 31,	
	2010	2009
Hospital revenue bonds and Certificates of Participation under the Sutter Health Master Indenture of Trust, fixed interest at 5.0% to 6.3%, due from 2011 to 2048 (net of premium of \$27 and \$31 at December 31, 2010 and 2009, respectively)	\$ 2,477	\$ 2,526
Hospital revenue bonds through the City of Modesto, fixed interest at 5.1% to 6.0%, due from 2010 to 2021 and prepaid in 2010	–	15
Various collateralized and unsecured obligations	10	11
Obligations under capital leases	6	1
	2,493	2,553
Less current portion	(71)	(63)
	\$ 2,422	\$ 2,490

The aggregate estimated fair market values of Sutter's long-term obligations at December 31, 2010 and 2009, of \$2,253 and \$2,378, respectively, were established using discounted cash flow analyses based on (i) the current market yield to maturity for similar types of publicly traded debt issues, and (ii) Sutter's current incremental borrowing rates for all other debt instruments.

The central financing vehicle of credit for Sutter is the Obligated Group. Sutter and certain affiliates are members of the Sutter Health Obligated Group, and the assets of such affiliates are subject to the indebtedness of the Obligated Group. Although the Obligated Group is not a legal entity, members of the Obligated Group are jointly and severally liable for repayment of the bonds under the terms of the California Health Facilities Financing Authority (CHFFA) and California Statewide Communities Development Authority (CSCDA) bonds. The related financing documents and various other debt agreements contain certain restrictive covenants requiring compliance by all members, including a pledge of gross revenue.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

7. LONG-TERM OBLIGATIONS (continued)

In January 2010, four tax-exempt obligation issues totaling \$39 of par value were redeemed or prepaid, which did not result in a loss.

In February 2011, Sutter issued \$275 of Series A CSCDA revenue bonds and \$475 Series B CHFFA revenue bonds. The proceeds of these borrowings were designated to finance or reimburse for a portion of capital expenditures at certain health care facilities and related facilities owned or operated by the Obligated Group.

In February 2011, a portion of two tax exempt obligation issues totaling \$49 of par value were redeemed or prepaid, which did not result in a loss.

Aggregate payments of long-term obligations, excluding capital leases, various collateralized and unsecured obligations, and bond premiums, are as follows as of December 31, 2010:

2011	\$	67
2012		18
2013		14
2014		14
2015		17
Thereafter		2,320
	\$	<u>2,450</u>

Sutter has an available \$399 revolving line of credit with a syndicate of banks with no outstanding borrowings as of December 31, 2010.

8. LEASES

Sutter leases various buildings, office space and equipment. The leases expire at various times and contain certain contingent rental provisions, guarantees and various renewal options. These leases are classified as either capital leases, which were not material as of December 31, 2010 and 2009, or operating leases based on the terms of the respective agreements. Certain operating leases relate to acute care facilities leased from various municipalities. Such operating lease agreements require Sutter to make specified capital improvements to the municipalities' facilities at various times.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

8. LEASES (continued)

Future minimum payments, by year and in the aggregate, under noncancellable operating leases with terms of one year or more at inception consist of the following as of December 31, 2010:

	Lease Payments	Sublease Receipts	Net Lease Payments
2011	\$ 89	\$ 3	\$ 86
2012	76	1	75
2013	66	1	65
2014	59	–	59
2015	55	–	55
Thereafter	251	–	251
	\$ 596	\$ 5	\$ 591

9. NET ASSETS AND CONTRIBUTIONS

Sutter receives donations through its philanthropic affiliates from the generosity of donors supporting certain programs and services. Donations with a restriction included in temporarily and permanently restricted net assets were maintained for the following purposes:

	December 31,	
	2010	2009
Temporarily restricted:		
Capital projects and medical equipment	\$ 104	\$ 97
Time restricted under trust agreements	25	30
Research and education	48	43
Other	48	34
	\$ 225	\$ 204
Permanently restricted – endowment	\$ 117	\$ 113

Unconditional promises to give cash or other assets are reported at fair market value at the date the promises are received. Conditional promises to give and indications of intentions to give are reported at fair market value when the conditions are met. Conditional promises were not material at December 31, 2010 and 2009.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

9. NET ASSETS AND CONTRIBUTIONS (continued)

As of December 31, 2010, pledges receivable (included in other receivables and other assets) consisted of the following unconditional promises to give:

Pledges due in 2011	\$	16
Pledges due 2012-2015		24
Pledges due after 2015		28
Less allowance for uncollectible pledges		(2)
Less discount on pledges receivable		(14)
	\$	<u>52</u>

Endowments: In September 2008, California Senate Bill No. 1329 was signed into law, enacting the Uniform Prudent Management of Institutional Funds Act (UPMIFA). UPMIFA eliminates the concept of “historic dollar value” and allows an institution to spend or accumulate as the board determines is prudent for the uses, benefits, purposes and duration of the endowment fund unless the gift instrument states a particular spending rate or formula. California’s version of UPMIFA also includes a rebuttable provision that spending greater than 7% of the average fair market value (calculated at least quarterly over a minimal period of three years) is presumed to be imprudent.

In accordance with UPMIFA, Sutter considers the following factors when appropriating or accumulating an endowment fund: (1) general economic conditions, (2) effects of inflation and deflation, (3) the purposes of the institution and the endowment fund, (4) expected total return from income and appreciation of investments, (5) Sutter’s other resources, (6) the duration and preservation of the endowment fund and (7) Sutter’s investment policies.

From time to time, the fair value of assets associated with individual endowment funds may fall below the level that the donor or UPMIFA requires Sutter to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were not material as of December 31, 2010 and 2009. These deficiencies resulted from unfavorable investment market fluctuations.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

9. NET ASSETS AND CONTRIBUTIONS (continued)

Sutter has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results while assuming a moderate level of investment risk.

To satisfy its long-term rate-of-return objectives, Sutter relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Sutter targets a diversified asset allocation that places a great emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

The endowment net asset composition by type of fund consists of the following:

	December 31, 2010			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 8	\$ 29	\$117	\$154
Board-designated funds	12	–	–	12
Total funds	\$ 20	\$ 29	\$117	\$166
	December 31, 2009			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 5	\$ 21	\$113	\$139
Board-designated funds	9	–	–	9
Total funds	\$ 14	\$ 21	\$113	\$148

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

9. NET ASSETS AND CONTRIBUTIONS (continued)

The changes in endowment net assets are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balance at January 1, 2009	\$ 3	\$ 8	\$ 98	\$ 109
Investment return:				
Investment income	1	1	–	2
Net appreciation (realized and unrealized)	14	13	3	30
Total investment return	15	14	3	32
Contributions	–	–	6	6
Appropriation of endowment assets for expenditure	(3)	(2)	–	(5)
Other changes:				
Transfers of endowment funds	–	–	4	4
Other	(1)	1	2	2
Balance at December 31, 2009	14	21	113	148
Investment return:				
Investment income	1	1	1	3
Net appreciation (realized and unrealized)	8	10	1	19
Total investment return	9	11	2	22
Contributions	–	–	3	3
Appropriation of endowment assets for expenditure	(3)	(3)	–	(6)
Other changes:				
Other	–	–	(1)	(1)
Balance at December 31, 2010	\$ 20	\$ 29	\$ 117	\$ 166

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

10. PATIENT SERVICE AND CAPITATION REVENUES

Sutter has agreements with third-party payers that provide for payments to Sutter at amounts different from its established rates. A summary of the payment arrangements with major third-party payers follows:

- *Medicare* – Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per diagnosis. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Certain inpatient nonacute services and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. Sutter is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Sutter and audits thereof by the Medicare fiscal intermediary. Sutter's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review. Sutter's Medicare cost reports have been audited by the Medicare fiscal intermediary generally through December 31, 2006.
- *Medi-Cal* – Inpatient and outpatient services rendered to Medi-Cal program beneficiaries are reimbursed either under contracted rates or reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Sutter and audits thereof by Medi-Cal. Sutter's Medi-Cal cost reports have been audited generally through December 31, 2006.

Adjustments from the finalization of prior-year cost reports from both Medicare and Medi-Cal resulted in an increase to patient service revenues of approximately \$9 in 2010 and \$15 in 2009.

Gross patient charges, including charges related to capitated patients, from the Medicare and Medi-Cal programs accounted for the following percentages of Sutter's gross patient service revenues:

	Year ended December 31,	
	2010	2009
Medicare	40%	39%
Medi-Cal	17%	15%

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

10. PATIENT SERVICE AND CAPITATION REVENUES (continued)

The healthcare industry is subject to voluminous and complex laws and regulations of federal, state and local governments. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement laws and regulations, anti-kickback and anti-referral laws and false claims prohibitions, and in the case of tax-exempt hospitals, the requirements of tax-exemption. In recent years, government activity has increased with respect to investigations and allegations concerning possible violations of reimbursement, false claims, anti-kickback and anti-referral statutes and regulations by healthcare providers. Sutter also operates an Ethics and Compliance Program, which reviews compliance with government healthcare program requirements and investigates allegations of non-compliance received from internal and external sources. From time to time findings may result in repayment of monies previously received from government payers and/or disclosure of such overpayments, including, but not limited to, disclosure to Centers for Medicare & Medicaid Services and its contracted agents, or the Office of Inspector General - Department of Health and Human Services. As a result, there is at least a reasonable possibility that the recorded estimates may change by a material amount in the near term.

Sutter also has entered into payment agreements with certain commercial insurance carriers, HMOs and preferred provider organizations. The basis for payment to Sutter under these agreements includes capitated arrangements, prospectively determined rates per diagnosis, discounts from established charges and prospectively determined daily rates.

Sutter, in the ordinary course of business, enters into various incentive-based risk sharing agreements with managed care payers and other providers. These agreements require retroactive settlement based on data that may not be available or finalized until all claims are processed. Settlement amounts have been estimated for such risk-based incentives based on available information. However, it is reasonably possible that these estimates may change in the near term.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

10. PATIENT SERVICE AND CAPITATION REVENUES (continued)

California enacted a twenty-one month quality assurance fee program for hospitals to obtain federal matching funds for Medi-Cal. The proceeds of the program and the federal matching funds are to be redistributed to California hospitals that treat Medi-Cal patients to fund certain Medi-Cal coverage expansions. Supplemental payments to be received of \$339 are included in patient service revenues and fees to be paid by Sutter related to the program of \$251 are included in other expenses for the period of April 1, 2009 through December 31, 2010. As of December 31, 2010, a receivable of \$66 is included in other receivables for the supplemental managed care payments to be received and \$3 is included in accounts payable for the pledge to the California Health Foundation Trust.

11. COMMUNITY BENEFIT EXPENSE

Services for the poor and underserved includes traditional charity care which covers health care services provided to persons who meet certain criteria and cannot afford to pay, as well as the unpaid costs of public programs treating Medi-Cal and indigent beneficiaries. Costs are computed based on a relationship of costs to charges. Services for the poor and underserved also include the cost of other services provided to persons who cannot afford health care because of inadequate resources and are uninsured or underinsured, and cash donations on behalf of the poor and needy.

Benefits for the broader community includes costs of providing the following services: health screenings and other health-related services, training health professionals, educating the community with various seminars and classes, the cost of performing medical research and the costs associated with providing free clinics and community services. Benefits for the broader community also includes contributions Sutter makes to community agencies to fund charitable activities.

The community benefit expense does not include the impact of the quality assurance fee program described in Note 10.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

11. COMMUNITY BENEFIT EXPENSE (continued)

The following is a summary of Sutter's estimated costs of providing services to the poor and broader community:

	Year ended December 31,	
	2010	2009
Services for the poor and underserved		
Traditional charity care	\$ 121	\$ 105
Unpaid costs of public programs:		
Medi-Cal	432	350
Other public programs	40	34
Other benefits for the poor and underserved	32	36
Total services for the poor and underserved	625	525
 Benefits for the broader community		
Nonbilled services	22	23
Education and research	95	90
Cash and in-kind donations	7	10
Other community benefits	2	2
Total benefits for the broader community	126	125
	\$ 751	\$ 650

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS

Sutter sponsors and participates in various employee benefit plans, including a noncontributory defined benefit plan (the “Retirement Plan”) and several contributory defined contribution plans. Sutter’s total retirement benefit expense was \$182 in 2010 and \$246 in 2009.

Sutter’s measurement date for plan assets, pension obligations and net periodic pension cost associated with the Retirement Plan is December 31. The changes in benefit obligations and plan assets for the Retirement Plan are as follows:

	December 31,	
	2010	2009
Projected benefit obligation at beginning of year	\$ 1,561	\$ 1,383
Service cost	117	110
Interest cost	99	89
Plan amendments	1	–
Actuarial loss	89	26
Benefits paid	(61)	(47)
Projected benefit obligation at measurement date	\$ 1,806	\$ 1,561
Fair value of plan assets at beginning of year	\$ 1,668	\$ 1,355
Actual gain return on plan assets	249	360
Employer contributions	120	–
Benefits paid	(61)	(47)
Fair value of plan assets at measurement date	\$ 1,976	\$ 1,668
Net prepaid (accrued) benefit costs at end of year	\$ 170	\$ 107

The accumulated benefit obligation for the Retirement Plan was \$1,536 and \$1,325 at December 31, 2010 and 2009, respectively.

Included in net assets at December 31, 2010 and 2009 are the following amounts that have not yet been recognized in net periodic benefit cost: unrecognized prior service costs of \$26 and \$32, respectively, and unrecognized actuarial losses of \$191 and \$218, respectively. The amounts included in net assets that are expected to be recognized in net periodic benefit cost during the year ended December 31, 2011, are \$6 for prior service cost.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

The benefits expected to be paid from the Retirement Plan in each of the next five years, and in the aggregate for the next five years are as follows:

2011	\$	78
2012		91
2013		103
2014		114
2015		126
2016-2019		818
		818
	\$	1,330

The actuarial assumptions used by the Retirement Plan are as follows:

	December 31,	
	2010	2009
Weighted average discount rates for calculating pension expense	6.0%	6.1%
Weighted average discount rates for calculating projected benefit obligation	5.7%	6.0%
Weighted average rates of compensation increase for calculating pension expense	5.3%	7.3%
Weighted average rates of compensation increase for calculating projected benefit obligation	5.3%	5.3%
Expected long-term rates of return on plan assets for calculating pension expense	8.5%	7.8%

The components of the Retirement Plan's net periodic benefit cost are as follows:

	Year ended December 31,	
	2010	2009
Service cost	\$ 117	\$ 110
Interest cost	99	89
Expected return on plan assets	(140)	(105)
Amortization of actuarial loss	7	48
Amortization of prior service cost	6	6
	\$ 89	\$ 148

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

In addition to the Retirement Plan, Sutter also has noncontributory postretirement health benefit plans (the “Health Plans”). The changes in benefit obligations for the Health Plans are as follows:

	December 31,	
	2010	2009
Projected benefit obligation at beginning of year	\$ 170	\$ 146
Prior period benefit (credit) cost	(3)	5
Service cost	8	7
Interest cost	10	9
Actuarial loss	6	7
Other change in benefit obligation	–	1
Benefits paid	(5)	(5)
Projected benefit obligation at measurement date	\$ 186	\$ 170
Fair value of plan assets at beginning of year	\$ 67	\$ 38
Actual gain on plan assets	10	11
Employer contributions	5	23
Benefits paid	(5)	(5)
Fair value of plan assets at measurement date	\$ 77	\$ 67
Net prepaid (accrued) benefit costs at end of year	\$ (109)	\$ (103)

An additional contribution to the Health Plans was made in February 2011 for the 2010 Plan Year of \$11.

The current portion of the net accrued benefit cost recorded was \$1 and \$1 at December 31, 2010 and 2009, respectively.

Included in net assets at December 31, 2010 and 2009 are the following amounts that have not yet been recognized in net periodic benefit cost: unrecognized prior service costs of \$26 and \$31, respectively, and unrecognized actuarial losses of \$6 and \$4, respectively. The amount included in net assets that is expected to be recognized in net periodic benefit cost during the year ended December 31, 2011 is approximately \$6 for prior service cost.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

The benefits expected to be paid from the Health Plans in each of the next five years, and in the aggregate for the next five years are as follows:

2011	\$	9
2012		11
2013		14
2014		16
2015		17
2016-2019		101
	\$	168

For the purposes of calculating retiree medical expense, the weighted average assumed discount rates were from 5.5% to 5.9% and 6.0% to 6.1% in 2010 and 2009, respectively, and the expected long-term rate of return on plan assets was 8.5% and 7.8% in 2010 and 2009, respectively.

The components of the Health Plans' net periodic benefit cost are as follows:

	Year ended December 31,	
	2010	2009
Service cost	\$ 8	\$ 7
Interest cost	10	9
Expected return on plan assets	(6)	(3)
Amortization of prior service cost	5	6
	\$ 17	\$ 19

Sutter's projected medical cost trend rate related to the Health Plans for 2011 through 2012 is 8%. The assumed medical cost trend rate is expected to gradually decrease in subsequent years to 5% in 2019 and thereafter. A one-percentage-point change in assumed health care cost trend rates would not have a material effect on Sutter's combined financial statements.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

The assets of the Retirement Plan and the Health Plans are under a single master trust (the “Master Trust”) with oversight from the Pension and Investment Committee of the Board of Directors. Management of the assets is governed by the application of modern portfolio theory, resulting in asset class diversification and mean-variance optimization. Sutter’s investment strategy for the Master Trust’s assets is to balance the liquidity needs of the Master Trust with the long-term return goals necessary to satisfy future obligations. The Master Trust participates in securities lending transactions through its trustee, Northern Trust Company (see Note 2 for a description of the securities lending program).

The target asset allocation seeks to reduce volatility while capturing the equity premium from the capital markets over the long-term and maintaining security of principal to meet near-term expenses and obligations. Periodically an asset allocation study is completed. As a result of the latest study, the weighted average target asset allocation compared to actual asset allocations at December 31, 2010 and 2009, by major asset category are as follows:

Major Asset Category	Target Allocation 2010	Percentage of Actual Plan Assets at December 31,	
		2010	2009
Cash and cash equivalents	1%	2%	1%
Equity securities	59%	69%	67%
Fixed income securities	20%	19%	21%
Other investments - alternative	15%	9%	9%
Real estate investments	5%	1%	2%
Total	100%	100%	100%

Equity securities are comprised of U.S. and foreign equity securities, common and collective trusts and commingled funds. The equity security’s target asset allocation of 59% is further comprised of 26% domestic large capitalization, 6% domestic small capitalization and 27% international.

The Master Trust’s portfolio return assumption of 8.5% for 2010 was based on the weighted-average return of comparative market indices for the major asset classes represented in the portfolio, net of administrative expenses.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

A fair value hierarchy has been established with three levels that prioritize the valuation inputs into each level (see Note 4). The fair value of the Master Trust's assets consists of the following:

	December 31, 2010			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance at December 31, 2010
Liquid investments				
Cash equivalents	\$ 73	\$ —	\$ —	\$ 73
Equity securities				
U.S. equity securities	658	—	—	658
Foreign equity securities	415	—	—	415
Common collective trusts and commingled funds	—	357	—	357
Fixed income securities				
U.S. government and agencies securities	24	14	—	38
U.S. federal agency mortgage-backed securities	—	69	—	69
Foreign government securities	—	144	—	144
U.S. corporate securities	—	89	—	89
Foreign corporate securities	—	31	—	31
Other investments				
Private equity funds	—	—	126	126
Real estate	—	—	7	7
Commodity linked funds	16	—	25	41
Accrued income	5	—	—	5
	<u>\$ 1,191</u>	<u>\$ 704</u>	<u>\$ 158</u>	<u>\$ 2,053</u>

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

	December 31, 2009			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance at December 31, 2009
Liquid investments				
Cash equivalents	\$ 35	\$ –	\$ –	\$ 35
Equity securities				
U.S. equity securities	540	–	–	540
Foreign equity securities	291	–	–	291
Common collective trusts and commingled funds	–	340	–	340
Fixed income securities				
U.S. government and agencies securities	30	10	–	40
U.S. federal agency mortgage-backed securities	–	65	–	65
Foreign government securities	–	140	–	140
U.S. corporate securities	–	80	–	80
Foreign corporate securities	–	26	–	26
Other investments				
Private equity funds	–	–	96	96
Real estate	–	–	41	41
Commodity linked funds	15	–	21	36
Accrued income	5	–	–	5
	<u>\$ 916</u>	<u>\$ 661</u>	<u>\$ 158</u>	<u>\$ 1,735</u>

Included in the assets disclosed above are securities on loan of \$116 and \$115 as of December 31, 2010 and 2009, respectively. In addition to the assets disclosed above, the Master Trust holds cash collateral for securities on loan of \$119 and \$119 as of December 31, 2010 and 2009, respectively.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

The change in the balance of Level 3 financial assets and liabilities measured on a recurring basis consist of the following:

	Private Equity Funds	Real Estate Investments	Commodity Linked Funds	Total
Balance at January 1, 2009	\$ 91	\$ 56	\$ –	\$ 147
Total net realized and unrealized gains (losses)	(11)	(14)	2	(23)
Purchases, issuances, and settlements, net	16	(1)	19	34
Balance at December 31, 2009	96	41	21	158
Total net realized and unrealized gains	5	6	4	15
Purchases, issuances, and settlements, net	25	(40)	–	(15)
Balance at December 31, 2010	<u>\$ 126</u>	<u>\$ 7</u>	<u>\$ 25</u>	<u>\$ 158</u>
Change in unrealized gains (losses) on investments held as of December 31, 2009	<u>\$ (4)</u>	<u>\$ (14)</u>	<u>\$ 2</u>	<u>\$ (16)</u>
Change in unrealized gains on investments held as of December 31, 2010	<u>\$ 5</u>	<u>\$ –</u>	<u>\$ 4</u>	<u>\$ 9</u>

There were no transfers between levels during 2010.

Two affiliates are members of a multiemployer defined benefit retirement plan that covers substantially all of the employees hired prior to January 1, 2010. For the multiemployer plan as a whole, the benefit obligation was \$780 and \$695 and the fair value of trust assets was \$662 and \$508 as of January 1, 2010 and 2009 (the most recent actuarial valuations available), respectively. The expense associated with these plans was \$30 in 2010 and \$33 in 2009.

Sutter maintains various defined contribution plans for eligible employees. Sutter's contributions to such plans were \$46 in 2010 and \$46 in 2009.

13. INCOME TAXES

Deferred income tax assets, which as of December 31, 2010 and 2009 were fully reserved, reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for income tax purposes. As of December 31, 2010 and 2009, Sutter had deferred tax assets of \$13 relating principally to net operating loss carryovers. As of December 31, 2010 and 2009,

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

13. INCOME TAXES (continued)

such deferred tax assets were offset by a valuation allowance of \$13. The valuation allowance did not change in 2010 or 2009. Federal net operating loss carryovers totaled \$32 at December 31, 2010 and will expire between 2015 and 2030. State of California net operating loss carryovers totaled \$4 at December 31, 2010 and will expire between 2011 and 2020. Sutter Health and its affiliates paid tax of \$1 in 2010 and \$2 in 2009.

14. FUNCTIONAL CLASSIFICATION OF EXPENSES

The following is a functional classification of Sutter's expenses:

	Year ended December 31,	
	2010	2009
Health services	\$ 7,665	\$ 7,309
General and administrative	766	714
	<u>\$ 8,431</u>	<u>\$ 8,023</u>

15. CONTINGENCIES AND COMMITMENTS

Contingencies: MGH, a former Sutter affiliate, operates an acute care hospital in Marin County pursuant to a lease with the Marin Healthcare District (the "Marin District"). Prior to June 29, 2010, Sutter was the sole corporate member of MGH. In accordance with a Settlement Agreement and Mutual Release and a separate Transfer Agreement (collectively, the "Transfer Agreements"), the Marin District became the sole member of MGH and re-acquired control of MGH on June 29, 2010 (the "Transfer Date"). Accordingly, Sutter has no further obligation or responsibility for MGH or its operations other than certain obligations as agreed to in the Transfer Agreements.

Over the course of 2009 and 2010, the Marin District has issued a number of notices of default, alleging failures of performance of various aspects of the Transfer Agreements by MGH or Sutter. Sutter has also issued notices of default relative to the Marin District's failure to perform certain of its obligations under the Transfer Agreements. Although the Transfer Agreements required that the parties exchange mutual releases at the closing of the Transfer, the Marin District declined to deliver an executed release and, therefore, Sutter did not deliver its executed release. On August 26, 2010, MGH filed a complaint against Sutter and three former MGH board directors alleging breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and violation of charitable trust laws. On December 23, 2010, Sutter's motion to compel arbitration was heard and subsequently granted. MGH has filed a writ to challenge the decision on the motion to compel arbitration. This matter is in its initial stage and no estimates of liability or conclusions

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

15. CONTINGENCIES AND COMMITMENTS (continued)

have been or can be reached relative to its impact. This matter, if decided adversely, may result in liability material to Sutter's combined financial condition or results of operations.

In addition to the arbitration matter discussed above, the Marin District alleges that MGH breached a 1999 Settlement Agreement between the Marin District and MGH. MGH has notified Sutter of its belief that Sutter is responsible for, and must indemnify and defend, MGH in this action. While Sutter management does not believe that Sutter is responsible for this action, Sutter intervened to expressly preserve its right to contest the responsibility for the defense of, or any liability resulting from, the action. Since filing the action, the Marin District filed a motion for summary judgment related to the action, which the court denied in February 2011. This matter is in its initial stage and no estimates of liability or conclusions have been or can be reached relative to its impact.

Sutter and certain affiliates are named in three class action complaints alleging meal and rest period and other wage-hour violations on behalf of nurses and technicians which have been coordinated in the Alameda County Superior Court. Sutter received an additional action complaint filed in Sacramento County on October 15, 2010. The complaint has since been amended to add another Sutter affiliate as a defendant. The complaint alleges that these affiliates did not appropriately pay out vested vacation wages to employees who terminated employment. These matters, if decided adversely, individually or in the aggregate, may result in liability material to Sutter's combined financial condition or results of operations.

Sutter received a class action complaint filed in Alameda County Superior Court on July 30, 2009. The complaint purports to represent a class of the employees in the information systems field. The complaint alleges that Sutter misclassified these employees as "exempt" and, accordingly did not properly provide them overtime pay, meal and rest periods and accurate wage statements. In November 2010, the court granted the parties' joint motion requesting preliminary court approval of a settlement. Sutter has recorded a liability based on the proposed settlement which did not result in liability material to Sutter's combined financial condition or results of operations.

In January 2007, a class action complaint was filed against Sutter alleging lack of accessibility to Sutter facilities for people with disabilities. In 2008, Sutter entered into a settlement agreement with the plaintiffs. The settlement terms address: (i) correction to certain physical barriers that may limit a disabled person's access to facilities; (ii) modification to or purchase of medical equipment to provide improved accessibility to medical equipment; and (iii) adoption of new policies and procedures to improve access to facilities. Assessment of physical barriers and potential modification is currently in

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

15. CONTINGENCIES AND COMMITMENTS (continued)

progress and is expected to continue for several years. It is difficult to estimate the cost of these proposed modifications and there can be no assurance that the resolution of these matters will not adversely affect Sutter's combined financial position or results of operations in the future.

In February 2010, Sutter acute care affiliates were served with a Qui Tam action. The complaint alleges, among other things, that Sutter hospitals have fraudulently billed for anesthesia services by billing on a time basis. The California Department of Insurance has reviewed this action and has elected to not intervene, although they have reserved the right to do so at a future point in time. No estimates of liability or conclusions have been or can be reached relative to this matter's impact and there can be no assurance that the resolution of this matter will not adversely affect Sutter's combined financial position or results of operations in the future.

As a part of its compliance activities, Sutter has undertaken an internal compliance audit process related to certain physician arrangements of certain affiliates. Although no final conclusions have been reached, Sutter elected to make voluntary self-disclosures to the federal government (in accordance with federal self-disclosure guidelines) related to certain physician financial arrangements that may constitute potential violations of federal regulatory standards. Enforcement remedies that may result from Sutter's voluntary disclosure could include payments to the government and/or the imposition of additional compliance requirements. At this time, management cannot accurately estimate the amounts of any payments or settlements that may result, or whether additional, related matters may arise. Although there can be no guarantee that any resulting payments or settlements will not be material in the aggregate, management does not expect any enforcement remedies regarding this matter to be material.

Sutter West Bay Hospitals, doing business as Sutter Medical Center of Santa Rosa, leases its hospital and related facilities (collectively, the "Chanate Campus") from Sonoma County. As part of the lease transaction, the parties entered into a Health Care Access Agreement, dated March 25, 1996 (the "HCAA").

The Chanate Campus must be replaced or retrofitted by December 31, 2014, to meet the applicable seismic standards. Sutter Medical Center of Santa Rosa submitted a plan to Sonoma County to build a new, earthquake safe Sutter Medical Center of Santa Rosa hospital as part of an integrated medical campus. In July 2009, Sonoma County Board of Supervisors unanimously approved a resolution confirming that Sutter Medical Center of Santa Rosa's plan and new hospital would meet the terms of the HCAA. In summer 2010, Sutter Medical Center of Santa Rosa received approval from Sonoma County to construct the new hospital. Construction has commenced and is scheduled to be

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

15. CONTINGENCIES AND COMMITMENTS (continued)

completed by December 31, 2014 at a cost of approximately \$284. Certain parties have filed a lawsuit challenging the approval based on alleged noncompliance with the California Environmental Quality Act. Construction is proceeding on schedule and Sonoma County and Sutter Medical Center of Santa Rosa intend to vigorously defend the lawsuit. If the plaintiffs prevail on all or a portion of the lawsuit, there may be increased costs due to delay or the possible need to abandon, change, or relocate the hospital.

Radiological Associates of Sacramento (RAS) has alleged that certain Sutter affiliates wrongfully diverted patients from the RAS location in Davis to Sutter radiology sites. RAS has also alleged that it had to close its Davis imaging location as a result of this alleged inappropriate patient diversion from the Davis location. The complaint by RAS seeks compensatory damages, lost income, an injunction, declaratory relief and attorneys' fees and costs. Arbitration has been set to begin in April 2011 to determine whether there were any inappropriate diversions. No estimates of liability or conclusions have been or can be reached relative to this matter's impact and there can be no assurance that the resolution of these matters will not adversely affect Sutter's combined financial position or results of operations in the future.

Sutter and an affiliate are named in a class action complaint alleging that Sutter and the affiliate failed to disclose the charge differential between inpatient and outpatient CT Scans and failed to obtain informed consent in that they failed to disclose the amount of radiation associated with CT Scans. The complaint seeks a judgment for all sums paid by class members for CT Scans, as well as a release of liability for unpaid charges for CT Scans performed without informed consent. Sutter and the affiliate have filed a demurrer to the complaint and motion to strike class action. No estimates of liability or conclusions have been or can be reached relative to this matter's impact and there can be no assurance that the resolution of these matters will not adversely affect Sutter's combined financial position or results of operations in the future.

Certain Sutter affiliates have received, and begun the process of responding to, a request to cooperate with the Department of Justice (the "DOJ") in a national investigation to determine whether Implantable Automatic Defibrillators provided to certain Medicare beneficiaries were provided in accordance with national coverage criteria. The DOJ's investigation spans a time frame beginning in 2003 and extending to present. This investigation is in its early stages, and no conclusions have been reached that the selected claims did not meet Medicare reimbursement criteria. No estimates of liability, if any, have been or can be reached relative to the impact of the investigation. However, there can be no assurance that the resolution of this investigation will not adversely affect Sutter's combined financial position or results of operations in the future.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

15. CONTINGENCIES AND COMMITMENTS (continued)

Sutter is involved in other litigation, as both plaintiff and defendant, and other routine labor matters, tax examinations and regulatory investigations and examinations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters should be resolved without a material adverse effect on Sutter's combined financial position or results of operations. However, there can be no assurance that this will be the case.

As of December 31, 2010, there are 47,000 Sutter employees, of which 26,000 are full-time employees. Approximately 27% of the Sutter employees (employed at twenty-three Sutter facilities) are represented by collective bargaining units. Of these employees, approximately 41% are represented by collective bargaining agreements that will expire in 2011. In addition, approximately 16% are represented by collective bargaining agreements that expired between 2007 and 2010 and are in the process of being negotiated. Employee strikes or other adverse labor actions may have a material adverse impact on Sutter's operations in the future.

Commitments: Eden Medical Center (EMC), a Sutter affiliate, leases a hospital facility known as San Leandro Hospital in San Leandro, California (San Leandro Hospital) from Eden Township Healthcare District (the "Eden District"). Pursuant to the terms of the initial lease, EMC agreed, subject to certain terms and conditions, to build a replacement for EMC's hospital facility. Sutter guaranteed EMC's performance of its obligations to build this replacement facility.

In March 2008, the Eden District, Sutter, and EMC entered into a series of agreements (collectively, the "2008 Agreements") to address certain disputes arising between the parties related to their respective rights and obligations under the initial lease and guaranty. Pursuant to the 2008 Agreements, Sutter agreed to develop and construct a 130-bed replacement facility on property adjacent to the existing hospital and demolish the existing Eden Hospital. The 2008 Agreements also included an Amended and Restated Lease and Hospital Operations Agreement (the "Amended Lease") for San Leandro Hospital. Pursuant to the Amended Lease and the 2008 Agreements, EMC received an option to purchase San Leandro Hospital and certain other properties (the "Option").

EMC exercised the Option to purchase San Leandro Hospital in July 2009, with a specified closing date of September 1, 2009. The Eden District declined to convey San Leandro Hospital's title to EMC. Sutter pursued the dispute resolution provisions of the 2008 Agreements and initiated the arbitration process.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

15. CONTINGENCIES AND COMMITMENTS (continued)

In March 2010, Sutter and the Eden District entered into a stipulation pursuant to which the Eden District agreed to an arbitrator's award that requires the Eden District to convey title of San Leandro Hospital to Sutter on or before March 31, 2010. The Eden District further stipulated to waive any claim for damages, but Sutter preserved its right to pursue damages in later proceedings before the arbitrator. The Eden District failed to convey title on or before March 31, 2010. However, the Eden District has filed a cross complaint in the pending action alleging that the 2008 Agreements, including the Option to purchase, are void in their entirety based on allegations of conflicts of interest within the meaning of California law. This cross complaint was filed in March 2010. On November 12, 2010, Sutter and EMC's Motion for Summary Judgment on the cross-complaint was granted and, as a result, the previously scheduled trial is no longer on calendar. On December 2, 2010, the Eden District filed a writ requesting review of the decision, which the Superior Court denied.

The parties are currently waiting for the Superior Court to file a judgment related to the granting of Sutter's Motion for Summary Judgment and the stipulated judgment that required Eden District to convey title of San Leandro Hospital to Sutter. Once this judgment is filed, the Eden District will have sixty (60) days within which to file an appeal of that judgment. Sutter expects the Eden District to file an appeal, which Sutter will vigorously challenge.

Sutter is required to remediate certain of its health care facilities to comply with earthquake retrofit requirements under a State of California law. During 2010, many of the hospitals have been reclassified and have received extensions through 2030 and Sutter is evaluating its facilities and is considering all options. Almost half of Sutter's facilities are compliant, have received extensions, or extensions are pending making the facilities compliant until 2030. There are five facilities currently in the construction phase with estimated expenditures of capital of \$1,000 that will bring those facilities into compliance and an additional \$1,800 is expected to be spent on new construction projects or remediation projects to address seismic requirements over the next five years. Sutter's capital allocation plan, which includes amounts for seismic retrofits, replacements, and relocations, is approximately \$6,500 (unaudited) from January 1, 2011 to December 31, 2015. Management and the Board of Directors evaluate Sutter's capital needs on an ongoing basis and are considering options given the current economic conditions.

16. SUBSEQUENT EVENT

Sutter has evaluated subsequent events and disclosed all material events through March 22, 2011, which is the date these financial statements of Sutter were issued.