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The Honorable Whitman L. Holt

8 UNITED STATES BANKRUPTCY COURT
 9 FOR THE EASTERN DISTRICT OF WASHINGTON

10 In re

11 ASTRIA HEALTH, *et al.*,

12 Debtors and Debtors in Possession¹,

Bankruptcy No. 19-01189-WLH7

**AHM, INC.'S OBJECTION TO
 SECOND AMENDED JOINT
 CHAPTER 11 PLAN OF
 REORGANIZATION OF ASTRIA
 HEALTH AND ITS DEBTOR
 AFFILIATES**

15 AHM Inc. a/k/a Astria Health Management f/k/a Ascentia Health

16 Management ("AHM") hereby objects to the Second Amended Joint Chapter 11
 17 Plan of Reorganization of Astria Health and Its Debtor Affiliates (the "Plan").
 18

19 The pertinent facts are as follows:
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23 ¹ The Debtors, along with their case numbers, are as follows: Astria Health (19-01189-11),
 24 Glacier Canyon, LLC (19-01193-11), Kitchen and Bath Furnishings, LLC (19-01194-11),
 25 Oxbow Summit, LLC (19-01195-11), SHS Holdco, LLC (19-01196-11), SHC Medical Center-
 26 Toppenish (19-01190-11), SHC Medical Center-Yakima (19-01192-11), Sunnyside
 Community Hospital Association (19-01191-11), Sunnyside Community Hospital Home
 Medical Supply, LLC (19- 01197-11), Sunnyside Home Health (19-01198-11), Sunnyside
 Professional Services, LLC (19-01199-11), Yakima Home Care Holdings, LLC (19-01201-11),
 and Yakima HMA Home Health (19-01200-11).

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1 AHM's Services to the Debtors

2 AHM provides C-level staffing and centralized management of functions
3 like human resources and information technology services for Debtor Astria
4 Health ("Astria") pursuant to an Executive Services Agreement (the "ESA").
5

6 Astria has received management and staffing services from AHM since
7 January 2018, and received substantially similar services prior to that from
8 AHM's predecessor HealthTech Management Services, Inc. ("HealthTech")
9 pursuant to an Agreement for Management Support Services (the "HealthTech
10 AMSS"). AHM is owned by John Gallagher and Cary Rowan. Since 2012, and
11 until recently, Mr. Gallagher has served as the President and CEO of Astria, and
12 Mr. Rowan has been its CFO.
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16 Throughout that time, both Mr. Gallagher and Mr. Rowan—along with the
17 rest of Astria's C-suite and most of its non-C-level system managers—have been
18 employees of AHM (or HealthTech), providing services to Astria pursuant to the
19 ESA (or HealthTech AMSS). To this day, all of Astria's C-suite with the
20 exception of its CRO (a former AHM employee) are currently AHM employees,
21 providing services under the ESA.
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24 Pursuant to the ESA, AHM provides Astria with its executive staff in
25 exchange for consideration that can be summarized as: (a) reimbursement by
26

1 Astria of AHM's payroll expenses for employees placed at Astria or one of its
2 hospitals (the "Payroll Reimbursement"), plus (b) payment of percentage of that
3 same payroll expense to reimburse AHM for the cost of providing benefits to
4 those employees (the "Benefits Charge").

6 Payroll Reimbursement includes salaries, bonuses, and—in certain defined
7 circumstances—severance packages pursuant to agreed compensation plans. The
8 Benefits Charge is a percentage of salaries that is determined each year, to match
9 the same percentage of salary expenses that Astria itself spends on benefits for its
10 own direct employees. Because the Payroll Reimbursement is a pure
11 reimbursement, the Benefits Charge is the only source of profit for AHM under
12 the ESA; AHM's profits depend on its ability to provide benefits to its employees
13 at a lower rate than Astria achieves for its own. It is important background to the
14 disputes addressed below that under the HealthTech AMSS, HealthTech charged
15 Astria for benefits at the higher rate of 30%.

19 It is also important to note that the ESA includes a non-competition clause.
20 During the term of the ESA and for one year thereafter, Astria is prohibited from
21 "directly or indirectly ... solicit[ing] for employment or hir[ing] any person to
22 work at [Astria] or any of its Hospitals who is employed by AHM at the time of
23 such solicitation or hire ... [or] any person who worked at [Astria] or its Hospitals
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1 at any time as an employee of AHM unless such person has not been employed
2 by AHM for at least one (1) year”
3

4 In addition to the ESA, further non-competition agreements have been
5 executed between AHM and its employees (who are staffed as Astria’s
6 executives). Those employees received monetary compensation for executing
7 such non-competition agreements, and pursuant to the agreements, the employees
8 are prohibited for 12 months after termination from AHM from “accept[ing]
9 employment with or otherwise perform[ing] services that [AHM] performs for
10 any hospital, health care facility, or related entity that [AHM], or its related
11 companies lease or manage.”
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14 Such restrictive covenants are typical in the industry and are designed to
15 benefit not only AHM but the Debtors, protecting Astria from seeing its own
16 executives—executives AHM worked to develop—complete against both of
17 them.
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19

20 During the course of a pending dispute between Lapis and AHM, which is
21 discussed below, Astria has feigned ignorance of these individual non-
22 competition agreements. Yet, they are specifically referenced in the ESA, along
23 with a provision for how the individual non-competition agreements might be
24 released. Further, the compensation paid to AHM employees in exchange for
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1 those agreements was included in the NICI to be reimbursed by Astria. To be
2 clear, these individual non-competition agreements were executed not only with
3 Astria's knowledge, but as its urging for its own further protection.
4

5 Deferred Bonuses and SERP Payments

6 Shortly prior to Astria's bankruptcy filing, both Mr. Gallagher and Mr.
7 Rowan deferred receipt of bonuses they were owed for their services rendered in
8 2018, in the total amount of \$657,623. Then, during the bankruptcy when Astria
9 faced a temporary cash-flow problem, Mr. Gallagher and Mr. Rowan agreed to
10 defer their receipt of payments under a Supplemental Executive Retirement Plan
11 (SERP) of \$52,624 in February 2020 and then again \$36,885 in September 2020.
12 These amounts were and are owed to Mr. Gallagher and Mr. Rowan by AHM;
13 Astria owes AHM reimbursement of those amounts under the ESA.
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17 Disputes with Lapis

18 Lapis Advisers, L.P. ("Lapis") is Astria's DIP lender herein, but has been
19 its largest creditor since September 2017.
20

21 When cash-flow improved at Astria, AHM resumed payment of the
22 deferred SERP payments to its employees. Lapis and Astria were both provided a
23 forward-looking cash flow statement of AHM executive expenses, broken down
24 by month, in July 2020. The statement incorporated the SERP payments, and no
25
26

1 problems were noted. However, in September 2020, Lapis unexpectedly objected
2 to the restarting of SERP payments.
3

4 Severance Packages

5 Under the ESA, Astria is obligated to reimburse AHM for severance pay
6 and other expenses associated with the termination of AHM employees.
7
8 Depending upon the outcome of the Plan's attempt to reject the ESA, Astria may
9 owe reimbursement for such severance packages to AHM.
10

11 AHM's Administrative Claim

12 The Request for Administrative Claim filed by AHM on July 29, 2020 (the
13 "AHM Admin Claim"), sets forth specific items of post-petition obligations under
14 the ESA. Additional items have come due since the AHM Admin Claim was
15 filed, which will need to be added to the claim pursuant to a reservation set forth
16 therein. Those items include severance payments, bonuses, and a \$10k deductible
17 for D&O insurance that are all to be reimbursed by Astria under the ESA.
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19

20 Lapis is expected to object to AHM's Admin Claim on various grounds,
21 mainly focused on (a) Lapis's position that the ESA is over-market, and (b)
22 Lapis's argument that the post-petition amounts owed under the ESA are not
23 "actual, necessary costs and expenses of preserving the estate" or otherwise
24 qualified administrative expenses under § 503(b).
25
26

1 Notably, Lapis has acquiesced to Astria's relationship with AHM for many
2 years, including Astria's funding of compensation through Lapis's cash collateral
3 during the pendency of this bankruptcy. Lapis has also made no objection to
4 Astria's *Notice of Intent to Compensate Insiders* (ECF No. 145; the "NICI") filed
5 herein over a year and half ago (May 28, 2019) that includes reimbursement to
6 AHM for bonuses owed to AHM.
7

8
9 The Plan

10 Lapis and the Debtors (the "Proponents") have now jointly proposed the
11 Plan, which is objectionable on the bases set forth below and in the numerous
12 other objections filed by other parties in interest.
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15 A. The Plan Relies Upon Violations of Non-Competition Agreements by
16 both Debtor and AHM Employees, and is Therefore Not Feasible

17 The Plan can only be confirmed is confirmation "is not likely to be
18 followed by the liquidation, or the need for further financial reorganization, of the
19 debtor or any successor to the debtor under the plan" 11 U.S.C. § 1129(a)(11).
20 In other words, the Plan must be feasible.
21

22 The Plan as written cannot be approved because it depends in part upon the
23 Astria directly hiring "all AHM employees currently serving as officers or
24 employees" of Astria; such direct hiring would be in violation of both the ESA
25 and of individual non-competition agreements entered into between AHM and its
26

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1 employees.

2 Under the ESA, during its term and for one year thereafter, Astria is
3 prohibited from “directly or indirectly ... solicit[ing] for employment or hir[ing]
4 any person to work at [Astria] or any of its Hospitals who is employed by AHM
5 at the time of such solicitation or hire ... [or] any person who worked at [Astria]
6 or its Hospitals at any time as an employee of AHM unless such person has not
7 been employed by AHM for at least one (1) year” The ESA excepts from his
8 prohibition anyone who was directly employed by Astria “immediately prior to
9 their employment by AHM.” ESA, ¶ 2.3.1. Out of the 19 AHM employees
10 currently placed with Astria, this exception would only permit Astria to solicit the
11 direct hiring of five.
12

13 All of those remaining employees, however, have entered into individual
14 non-competition agreements with AHM, as discussed above. Those employees
15 are prohibited for 12 months after termination from AHM from “accept[ing]
16 employment with or otherwise perform[ing] services that [AHM] performs for
17 any hospital, health care facility, or related entity that [AHM], or its related
18 companies lease or manage.”
19

20 In sum, the Plan requires both Astria and AHM’s individual employees to
21 breach their contractual non-competition agreements with AHM – breaches that
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1 AHM will seek to enjoin. The Plan includes no provision for payment of damages
2 to AHM for Astria's own breach of the ESA, nor does it do anything to insulate
3 individual AHM employees from similar damages claims for their own proposed
4 (by the Plan) breaches of non-competition agreements. Enforcement of these non-
5 competition agreements by AHM, or voluntary compliance by individual
6 employees, means that Astria will be unable to maintain its management team
7 through a reorganization.
8
9

10 The Disclosure Statement itself acknowledges the crucial role that AHM's
11 employees play to Astria's reorganization. "Of particular importance to the
12 Debtors' efforts to stabilize their businesses and continue their operations
13 uninterrupted was their ability to maintain the continued support and cooperation
14 of their employees." Dkt. 1987, at 32 (Disclosure Statement, § V.B.3.).
15
16

17 Importantly, Astria's entire C-suite (with the exception of the CRO) and the
18 majority of its non-C-level administrative managers are all AHM employees who
19 will be lost following rejection of the ESA. The sudden loss of this entire
20 management group will make ongoing operations essentially impossible, meaning
21 implementation of the Plan is infeasible and therefore unconfirmable.
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1 B. Astria's Employment of Executives Under the Plan, in Violation of
2 Contractual Agreements, is Not Consistent with the Interests of
3 Creditors or Public Policy

4 It is a prerequisite to confirmation of the Plan that the “proponent of the
5 plan has disclosed the identity and affiliations of any individual proposed to
6 serve, after confirmation of the plan, as a director, officer, or voting trustee of the
7 debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a
8 successor the debtor under the plan; and ... the appointment to, or continuance in,
9 such office of such individual, is consistent with the interests of creditors ... and
10 with public policy.” 11 U.S.C. § 1129(a)(5)(A).
11
12

13 The Plan indicates that its proponents expect “that all AHM employees
14 currently serving as officers or employees of the Debtors will be offered
15 employment by AH System, effective on the Effective Date.” Dkt. 1986, at 39 (§
16 III. I.). The Disclosure Statement identifies the CEO and CFO currently serving
17 as Brian Gibbons and Maxwell Owens, respectively; it does not otherwise
18 identify all individuals proposed to serve as directors and officers. Dkt. 1987, at
19 67. Moreover, it does not correctly identify the “affiliation” of Mr. Gibbons and
20 Mr. Owens, referring to them as having been “formerly employed by AHM,”
21 where in fact there are currently still employed by AHM. Dkt. 1987, at 25
22 (Disclosure Statement, § IV. A. 3.).
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1 More importantly, however, for the reasons discussed above, Astria's direct
2 employment of Mr. Gibbons, Mr. Owens, and any other AHM employee would
3 not be in the best interests of creditors or in the interest of public policy. Such
4 employment would violate the contractual agreements that both Astria and
5 relevant individual employees each made with AHM, specifically with respect to
6 non-competition clauses in those contracts; such violations of contracts are
7 against the public policy. Further, creditors would be harmed because such direct
8 employment would open Astria up to a claim for significant damages based on
9 those contract violations. Finally, AHM expects that many of its employees will
10 not choose to violate their non-competition agreements, and will thus decline
11 employment with Astria; creditors are likewise harmed by this outcome, in that it
12 makes reorganization unfeasible, as discussed above.

17 C. The Administrative Claim Cap is Not Fair and Equitable

18 The Plan separately addresses "Administrative Claims" and what it calls
19 "Ordinary Course Administrative Expenses," the latter of which is defined as:
20

21 Administrative Claims for goods and services of types
22 consistent with the Debtors' ordinary course business
23 operations as of the Petition Date that will be paid as they come
24 due after the Effective Date in the ordinary course of
Reorganized Debtors' business.

25 As explained above, Astria has been operating under the ESA and its
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1 predecessor agreements for the purpose of filling its entire C-level executive suite
2 for many years prior to the filing of this bankruptcy. This would seem to indicate
3 that AHM's services to Astria over those many years would be "consistent with
4 the Debtors' ordinary course business operations" and that all amounts payable
5 under the ESA would therefore be "paid as they come due" under the Plan. To the
6 extent that is the Proponents' intention, AHM has no objection that treatment.
7

8
9 However, to date the Debtors have decidedly not been paying amounts
10 owed under the ESA as they come due, and instead Astria and Lapis have made
11 clear their intent to continue not making such payments and to instead object to
12 the AHM Admin Claim in its entirety. Based on that, it would appear that the
13 Proponents intend to treat AHM's claim as a general "Administrative Claim"
14 under the Plan. As to that treatment, AHM does object.
15

16
17 The Plan sets forth an "Administrative, Professional and Priority Claims
18 Cap" (the "Admin Claim Cap") of \$4,624,674, "which shall be the maximum
19 amount payable under the Plan for the payment of pre-Effective Date U.S.
20 Trustee Fees and Administrative, Priority Tax, Priority, and Professional Fee
21 Claims on or after the Effective Date."
22

23
24 AHM's own administrative claim is currently estimated to be
25 approximately \$3,096,800. This is, of course, in addition to many millions of
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1 additional dollars in Administrative Claims submitted by other creditors, the total
2 of which far exceeds the Admin Claim Cap proposed by the Plan.
3

4 In order for the Plan to be approved without approval from all impaired
5 classes, its proponents must establish that it is “fair and equitable, with respect to
6 each class of claims or interests that is impaired under, and has not accepted the
7 plan.” 11 U.S.C. §1129(b)(1). “Fair and equitable” includes the requirement that
8 holders of claims junior to the relevant impaired class “will not receive or retain
9 under the plan on account of such junior claim or interest any property” 11
10 U.S.C. § 1129(b)(2)(B)(ii). Yet, the Plan provides for payments to be made to
11 junior classes, including on general unsecured claims, while failing to actually
12 pay Administrative Claims in full.
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16 Moreover, while the Plan makes effectiveness conditional upon the “actual
17 and anticipated Allowed Administrative, Professional and Priority Claims” not
18 exceeding the Admin Claim Cap, it also allows for waiver of that (and any other)
19 condition “by the Debtors with the prior written consent of the Lapis Parties and
20 the Committee.” In other words, the Debtor can simply fail to makes funds
21 available for payment of the AHM Admin Claim so long as Lapis and the
22 Committee—both of whom have already indicated their intention to oppose the
23 AHM Admin Claim—agree.
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1 Finally, the Plan also leaves open to the Debtors the option of assuming
2 contracts even after the Effective Date by filing a motion to allow such
3 assumption before the Effective Date. Such assumption creates even further
4 opportunity for an increase in administrative claims beyond the Cap, long after
5 that Cap is set, in the form of increased cure costs for any contracts assumed.
6 AHM's current pre-petition claim that would need to be cured if the Debtors
7 assumed the ESA, for example, is \$3,160,772.
8

9
10 Notably, the Plan does not treat administrative claims as an impaired class,
11 and therefore does not offer administrative claimants the right to vote. Yet, based
12 on the existence of this cap, administrative claimants are impaired. Having been
13 denied the opportunity to vote, they cannot be deemed to have accepted the Plan
14 with that impairment intact.
15

16
17 D. Rejection of the ESA Does Not Constitute Sound Business Judgment
18

19 Section 365(a) permits the Debtors to reject executory contracts; however,
20 the Court should not permit such rejection where the rejection is not based on
21 sound business judgment. *In re Pomona Valley Med. Grp., Inc.*, 476 F.3d 665,
22 670-71 (9th Cir. 2007). "The primary question to guide the court in deciding
23 whether a debtor has properly exercised its business judgment is whether
24 rejection would benefit the general unsecured creditors. Rejection should not be
25
26

1 allowed where the primary beneficiaries of rejection would be the debtors, not
2 creditors.” *In re Hertz*, 536 B.R. 434, 442 (Bankr. C.D. Cal. 2015).
3

4 As confirmed by the Disclosure Statement, rejecting the ESA is not sound
5 business judgment because it is “of particular importance to the Debtors’ efforts
6 to stabilize their businesses and continue their operations uninterrupted” that they
7 are able to “maintain the continued support and cooperation of their employees.”
8 Dkt. 1987, at 32. Rejecting the ESA means Astria will lose nearly its entire
9 executive staff, all at once and at a time when the Debtors face a critical transition
10 into reorganization.
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13 Further, rejection of the ESA will lead to rejection damages for Astria’s
14 breach of contract in the approximate amount of \$1.2 Million. This represents
15 approximately \$600,000.00 per year for the remainder of the ESA term, which is
16 AHM’s annual profit margin under the ESA.
17
18

19 Lapis has argued that Astria should reject the ESA because it claims
20 compensation by AHM—for which Astria is contractually obligated to reimburse
21 AHM—was excessive. Aside from Lapis’s years-long acquiescence to the
22 arrangement, the position is also unsupportable. The compensation plan was
23 created in consultation with Arthur J. Gallagher & Co. (no relation), one of the
24 leading providers of compensation and benefits data in the county, which
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26

1 conducted two separate compensation analyses over the last several years.
2 AHM's salary and benefits packages for its employees are well within market
3 range for similar officers in companies the size of Astria, and neither Astria, the
4 Committee, nor Lapis has ever raised a complaint about the compensation until
5 very recently.
6

7
8 E. Astria Improperly Attempts to Reject Only Part of the ESA

9 If the Debtors wish to reject the ESA, and to the extent the Court permits
10 rejection, they must reject it entirely and may no longer take advantage of any
11 rights otherwise afforded to Astria thereunder. Debtors may not reject the ESA
12 only partially. *In re MF Glob. Holdings Ltd.*, 466 B.R. 239, 241 (Bankr. S.D.N.Y.
13 2012) ("An executory contract may not be assumed in part and rejected in part.");
14 *In re Fifth Taste Concepts Las Olas, LLC*, 325 B.R. 42, 45 (Bankr. S.D. Fla.
15 2005) ("A debtor cannot choose to accept the benefits or desirable features of the
16 contract and reject the burdens or undesirable features of the contract to the
17 detriment of the other party."); *In re Nagel*, 216 B.R. 397, 398 (Bankr. W.D. Tex.
18 1997) ("It is hornbook law that an executory contract cannot be assumed in part
19 and rejected in part. It is either all or nothing.").

20 Astria wishes to take advantage of the opportunity afforded by the ESA to
21 continue enjoying the services of its existing management team, but does not wish
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1 to perform its obligations under the ESA to reimburse AHM for those same
2 employees' compensation. More specifically, the Plan sets forth the Debtors'
3 intention to pay some of AHM's employees directly for amounts they are owed
4 by AHM, and for which Astria actually owes reimbursement to AHM, while
5 refusing to pay for the compensation of other employees.
6
7

8 The Debtors also seemingly wish to take advantage of a provision of the
9 ESA under which AHM might release its employees from individual non-
10 competition agreements, in exchange for mutually-agreeable severance
11 agreements between AHM and those employees, again without fulfilling Astria's
12 own obligations to reimburse AHM for the cost associated with those severance
13 agreements.
14
15

16 Finally, it is important to note that Astria has obligations to indemnify
17 AHM for certain claims by employees under the ESA. Those obligations to
18 indemnify cannot be rejected, and any order permitting rejection of the ESA
19 should make clear that Astria is not alleviated of its indemnification obligations.
20

21 F. AHM Did Not Receive a Ballot, Votes to Reject the Plan and Opt Out
22 of Releases
23

24 AHM did not receive the opportunity to vote on this Plan – it was not
25 provided a ballot. Let this objection serve as notice that AHM wishes to exercise
26

1 its vote against the Plan. Further, AHM hereby expressly opts out of any releases
2 set forth in the Plan, and reserves all rights against any of the Released Parties
3 identified in the Plan.
4

5 DATED this 13th day of December, 2020.

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7

8 By /s/ Daniel J. Bugbee

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1 **CERTIFICATE OF SERVICE**

2 I, Dominique Scalia, hereby certify on December 13, 2020, I
3 electronically filed the foregoing document with the Clerk of the Court using
4 the CM/ECF system which, pursuant to Local Rule 5005-1(c)(1), causes
5 parties who are registered ECF participants to be served by electronic means.
6

7 Dated this 13th day of December, 2020 at Seattle, Washington.

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9

10 By /s/ Dominique R. Scalia
11 Dominique R. Scalia, WSBA No.
12 47313
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