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7 Debtors In Possession

8 **UNITED STATES BANKRUPTCY COURT**

9 **CENTRAL DISTRICT OF CALIFORNIA - LOS ANGELES DIVISION**

10 In re

11 VERITY HEALTH SYSTEM OF
CALIFORNIA, INC., *et al.*,

12 Debtors and Debtors In Possession.

Lead Case No. 2:18-bk-20151-ER

Jointly Administered With:

- CASE NO.: 2:18-bk-20162-ER
- CASE NO.: 2:18-bk-20163-ER
- CASE NO.: 2:18-bk-20164-ER
- CASE NO.: 2:18-bk-20165-ER
- CASE NO.: 2:18-bk-20167-ER
- CASE NO.: 2:18-bk-20168-ER
- CASE NO.: 2:18-bk-20169-ER
- CASE NO.: 2:18-bk-20171-ER
- CASE NO.: 2:18-bk-20172-ER
- CASE NO.: 2:18-bk-20173-ER
- CASE NO.: 2:18-bk-20175-ER
- CASE NO.: 2:18-bk-20176-ER
- CASE NO.: 2:18-bk-20178-ER
- CASE NO.: 2:18-bk-20179-ER
- CASE NO.: 2:18-bk-20180-ER
- CASE NO.: 2:18-bk-20171-ER

Chapter 11 Cases

Hon. Judge Ernest M. Robles

EMERGENCY MOTION OF DEBTORS FOR ENTRY OF ORDER: (I) AUTHORIZING THE DEBTORS TO (A) PAY PREPETITION EMPLOYEE WAGES AND SALARIES, AND (B) PAY AND HONOR EMPLOYEE BENEFITS AND OTHER WORKFORCE OBLIGATIONS; AND (II) AUTHORIZING AND DIRECTING THE APPLICABLE BANK TO PAY ALL CHECKS AND ELECTRONIC PAYMENT REQUESTS MADE BY THE DEBTORS RELATING TO THE FOREGOING; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

[Filed Pursuant to LBR 2081-1(a)(6) and 9075-1(a)]

[Declaration of Richard G. Adcock in Support of

19 Affects All Debtors

20 Affects Verity Health System of
California, Inc.

21 Affects O'Connor Hospital

22 Affects Saint Louise Regional Hospital

23 Affects St. Francis Medical Center

24 Affects St. Vincent Medical Center

25 Affects Seton Medical Center

26 Affects O'Connor Hospital Foundation

27 Affects Saint Louise Regional Hospital
Foundation

28 Affects St. Francis Medical Center of
Lynwood Foundation

Affects St. Vincent Foundation

Affects St. Vincent Dialysis Center, Inc.

Affects Seton Medical Center Foundation

Affects Verity Business Services

Affects Verity Medical Foundation

Affects Verity Holdings, LLC

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Affects De Paul Ventures, LLC
 Affects De Paul Ventures - San Jose
Dialysis, LLC

Debtors and Debtors In Possession.

Debtors' First Day Motions filed concurrently
herewith]
EMERGENCY HEARING:
Date: September 5, 2018
Time: 10:00 a.m.
Place: Courtroom 1568
U.S. Bankruptcy Court
255 East Temple Street
Los Angeles, CA 90012

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EMERGENCY MOTION

1
2 Verity Health System of California, Inc. (“VHS”) and the above-referenced affiliated
3 debtors (collectively, the “Debtors”), the debtors and debtors in possession in the above-captioned
4 Chapter 11 bankruptcy cases (collectively, the “Cases”), hereby move, on an emergency basis
5 (the “Motion”), pursuant to §§ 105(a), 363(b), 507(a), 1107(a) and 1108 of title 11 of the United
6 States Code (the “Bankruptcy Code”),¹ for the entry of an order: (i) authorizing the Debtors, in
7 their discretion, to (a) pay prepetition employee wages and salaries, and (b) pay and honor
8 employee benefits and other workforce obligations (including remitting withholding obligations,
9 maintaining workers’ compensation and benefits programs, paying related administration
10 obligations, making contributions to retirement plans, and paying reimbursable employee
11 expenses); and (ii) authorizing and directing the applicable bank to pay all checks and electronic
12 payment requests made by the Debtors relating to the foregoing (collectively, the “Employee
13 Obligations”). In support of the Motion, the Debtors have separately filed the Declaration of
14 Richard G. Adcock in Support of Debtors’ First Day Motions (the “Adcock Declaration”).

SUMMARY OF REQUESTED RELIEF

15
16 The Debtors request that the relief sought herein be granted on an emergency basis
17 because they will suffer irreparable harm without the relief requested in this Motion. The
18 Debtors’ employees are vital to the operation of the Debtors’ hospitals and its medical clinics, and
19 to the health, welfare, safety and security of the patients who seek medical care therein. Payment
20 of, and otherwise honoring, the Employee Obligations are necessary to prevent employees from
21 terminating their employment with the Debtors and to maintain the employees’ morale pending
22 resolution of these Cases. Specifically, in satisfaction of Rule 2081-1(a)(6) of the Local
23 Bankruptcy Rules of the United States Bankruptcy Court for the Central District of California
24 (the “LBR”):

- 25 (A) the employees regarding whom relief is requested are still employed by the
26 Debtors;

27
28 ¹ All references to “§” or “sections” herein are to sections of the Bankruptcy Code.

- 1 (B) the proposed payments to employees are absolutely necessary;
- 2 (C) these proposed payment procedures are beneficial to the Debtors' estates;
- 3 (D) with the requested first-day relief, the Debtors' prospect of reorganization is
- 4 heightened;
- 5 (E) the Debtors do not seek to pay any prepetition claims of any insiders at this time;
- 6 (F) the employees' claims are within the limits established by § 507; and
- 7 (G) the proposed payments will not render the Debtors' estates administratively
- 8 insolvent.

9 Therefore, pursuant to LBR 2081-1(a)(6), the Debtors request that this Motion be heard on an
10 emergency basis.²

11 **ADDITIONAL INFORMATION**

12 The Motion is based on the Notice of Emergency Motions that will be filed and served
13 after a hearing date for the Debtors' "First Day Motions" has been obtained, the attached
14 Memorandum of Points and Authorities, the Adcock Declaration, and the arguments of counsel
15 and other admissible evidence properly brought before the Court at or before the hearing
16 regarding the Motion. In addition, the Debtors request that the Court take judicial notice of all
17 documents filed with the Court in this case.

18 Counsel to the Debtors will serve this Motion, the attached Memorandum of Points and
19 Authorities, the Adcock Declaration and the Notice of First Day Motions on: (i) the Office of the
20 United States Trustee; (ii) any alleged secured creditors; (iii) the fifty largest general unsecured
21 creditors appearing on the list filed in accordance with Rule 1007(d) of the Federal Rules of
22 Bankruptcy Procedure (the "Bankruptcy Rules"); (iv) the United States of America, and the State
23 of California; and (v) parties that file with the Court and serve upon the Debtors requests for
24 notice of all matters in accordance with Bankruptcy Rule 2002(i). To the extent necessary, the
25 Debtors request that the Court waive compliance with LBR 9075-1(a)(6) and approve service (in
26 addition to the means of services set forth in such LBR) by overnight delivery. Among other

27 _____
28 ² Pursuant to LBR 9075-1(a)(4), no separate motion for an expedited hearing is required.

1 things, the Notice of Emergency Motions will provide that any opposition or objection to the
2 Motion may be presented at any time before or at the hearing regarding the Motion, but that
3 failure to timely object may be deemed by the Court to constitute consent to the relief requested
4 herein.

5 In the event that the Court grants the relief requested by the Motion, the Debtors shall
6 provide notice of the entry of the order granting such relief upon each of the foregoing parties and
7 any other parties in interest as the Court directs. The Debtors submit that such notice is sufficient
8 and that no other or further notice be given.

9 **WHEREFORE**, for all the foregoing reasons and such additional reasons as may be
10 advanced at or prior to the hearing regarding this Motion, the Debtors respectfully request that the
11 Court enter an order providing for the following relief: (i) authorizing the Debtors, in their
12 discretion, to (a) pay prepetition employee wages and salaries, and (b) pay and honor employee
13 benefits and other workforce obligations (including remitting withholding obligations,
14 maintaining workers' compensation and benefits programs, paying related administration
15 obligations, and paying reimbursable employee expenses); (ii) authorizing and directing the
16 applicable bank to pay all checks and electronic payment requests made by the Debtors relating to
17 the foregoing; and (iii) granting such other and further relief as is just and proper under the
18 circumstances.

19 Dated: August 31, 2018

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20 By /s/Tania M. Moyron
21 Tania M. Moyron

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1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 **I.**

3 **INTRODUCTION**

4 The Debtors request, pursuant to LBR 2081-1(a)(6) and 9075-1(a) and §§³ 105(a), 363(b),
5 507(a), 1107(a) and 1108 of the Bankruptcy Code, entry of an order on an emergency basis in
6 these cases: (i) authorizing, but not directing, the Debtors, in their discretion, to (a) pay or honor
7 prepetition wages, salaries, employee benefits, and other compensation, (b) remit withholding
8 obligations, (c) maintain workers' compensation and benefits programs, (d) pay related
9 administration obligations, and (e) pay reimbursable employee expenses (collectively, the
10 "Employee Obligations"); and (ii) authorizing and directing the applicable bank to pay all checks
11 and electronic payment requests made by the Debtors relating to the foregoing.

12 The Debtors' goals in these Cases are to facilitate an orderly administration of their Cases
13 and to maintain efficient and seamless operations for the benefit of the patients (the "Patients")
14 who seek medical care in the Hospitals (defined below) and medical clinics operated by the
15 Debtors in order to maximize the value of their assets for the benefit of all stakeholders.
16 Accordingly, it is imperative to the accomplishment of the Debtors' goals in these Cases that the
17 Debtors minimize any adverse impact of the chapter 11 filing on the Debtors' workforce, on the
18 Patients, on the operations of the Hospitals and medical clinics, and on the orderly administration
19 of these Cases. Any disruption to payment of the payroll in the ordinary course, or to the
20 continued implementation of employee programs in the Debtors' discretion, would adversely
21 affect the Debtors' goals in this case because such events could cause some employees to
22 terminate their employment with the Debtors, could cause employees to be distracted from their
23 duties to care for the Patients and the operations of the Hospitals and medical clinics, and could
24 hurt employee morale at a particularly sensitive time for all employees. Failure to honor payroll
25 and employee benefits obligations could have severe repercussions on the Debtors' ability to
26
27

28 ³ All references to "§" or "section" herein are to the Bankruptcy Code, 11 U.S.C. §§ 101, *et seq.*, as amended

1 preserve their assets and administer their estates, to the detriment of all constituencies.

2 Accordingly, the Debtors respectfully request that the Court grant the Motion.

3 **II.**

4 **JURISDICTION**

5 The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. This
6 is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). The venue of the Cases is proper
7 pursuant to 28 U.S.C. §§ 1408 and 1409.

8 **III.**

9 **STATEMENT OF FACTS**

10 **A. General Background**

11 1. On August 31, 2018 (“Petition Date”), Verity Health System of California, Inc.
12 (“VHS”) and the above-referenced affiliated debtors, the debtors and debtors in possession in the
13 above-captioned chapter 11 bankruptcy cases (collectively, the “Debtors”), each filed a voluntary
14 petition for relief under chapter 11 of title 11 of the United States Code (the “Bankruptcy
15 Code”).⁴ Since the commencement of their cases, the Debtors have been operating their
16 businesses as debtors in possession pursuant to §§1107 and 1108 of the Bankruptcy Code.

17 2. Debtor VHS, a California nonprofit public benefit corporation, is the sole
18 corporate member of the following five Debtor California nonprofit public benefit corporations
19 that operate six acute care hospitals: O’Connor Hospital, Saint Louise Regional Hospital, St.
20 Francis Medical Center, St. Vincent Medical Center, Seton Medical Center, and Seton Medical
21 Center Coastside (collectively, the “Hospitals”) and other facilities in the state of California.
22 Seton Medical Center and Seton Medical Center Coastside operate under one consolidated acute
23 care license.

24 3. VHS, the Hospitals, and their affiliated entities (collectively, “Verity Health
25 System”) operate as a nonprofit health care system, with approximately 1,680 inpatient beds, six
26
27

28 ⁴ All references to “§” or “section” herein are to the Bankruptcy Code, 11 U.S.C. §§ 101, *et seq.*, as amended.

1 active emergency rooms, a trauma center, eleven medical office buildings, and a host of medical
2 specialties, including tertiary and quaternary care.

3 4. The VHS affiliated entities, including the Debtors and non-debtor entities, are as
4 follows:

- 5 • O'Connor Hospital ("OCH")
- 6 • Saint Louise Regional Hospital ("SLRH")
- 7 • St. Francis Medical Center ("SFMC")
- 8 • St. Vincent Medical Center ("SVMC")
- 9 • Seton Medical Center ("SMC"), including Seton Medical Center Coastside
10 campus ("SMCC")
- 11 • Verity Business Services ("VBS")
- 12 • Marillac Insurance Company, Ltd.
- 13 • O'Connor Hospital Foundation ("OCH-F")
- 14 • Saint Louise Regional Hospital Foundation ("SLRH-F")
- 15 • St. Francis Medical Center of Lynwood Foundation ("SFMC-F")
- 16 • St. Vincent Medical Center Foundation ("SVMC-F")
- 17 • Seton Medical Center Foundation ("SMC-F")
- 18 • St. Vincent de Paul Ethics Corporation
- 19 • St. Vincent Dialysis Center
- 20 • De Paul Ventures, LLC
- 21 • De Paul Ventures - San Jose Dialysis, LLC
- 22 • De Paul Ventures - San Jose ASC, LLC
- 23 • Verity Medical Foundation ("VMF")
- 24 • Verity Holdings, LLC ("Holdings")

25 5. VMF, incorporated in 2011, is a medical foundation, exempt from licensure under
26 California Health & Safety Code § 1206(l). VMF contracts with physicians and other healthcare
27 professionals to provide high quality, compassionate, patient-centered care to individuals and
28 families throughout California. With more than 100 primary care and specialty physicians, VMF
offers medical, surgical and related healthcare services for people of all ages at community-based,
multi-specialty clinics conveniently located in areas served by the Debtor Hospitals. VMF holds
long-term professional services agreements with the following medical groups: (a) Verity
Medical Group; (b) All Care Medical Group, Inc.; (c) CFL Children's Medical Associates, Inc.;
(d) Hunt Spine Institute, Inc.; (e) San Jose Medical Clinic, Inc., D/B/A San Jose Medical Group;
and (f) Sports, Orthopedic and Rehabilitation Associates.

6. Holdings is a direct subsidiary of its sole member VHS and was created in 2016 to
hold and finance VHS' interests in four medical office buildings whose tenants are primarily

1 physicians, medical groups, healthcare providers, and certain of the VHS Hospitals. Holdings’
2 real estate portfolio includes more than 15 properties. Holdings is the borrower on approximately
3 \$66 million of non-recourse financing secured by separate deeds of trust and revenue and
4 accounts pledges, including the rents on each medical office building.

5 7. OCH-F, SLRH-F, SFMC-F, SVMC-F, and SMC-F handle fundraising and grant-
6 making programs for each of their respective Debtor Hospitals.

7 8. As of August 31, 2018, the Debtors have approximately 7,385 employees, of
8 whom 4,733 are full-time employees. Approximately 74% of these employees are represented by
9 collective bargaining units. A majority of the employees are represented by either the Service
10 Employees International Union (approximately 39% of employees) or California Nurses
11 Associations (approximately 22% of employees).

12 9. Each of the Debtors is exempt from federal income taxation as an organization
13 described in Section 501(c)(3) of the Internal Revenue Code of 1986, except for Verity Holdings,
14 LLC, DePaul Ventures, LLC, and DePaul Ventures - San Jose Dialysis, LLC.

15 10. To date, no official committee or examiner has been appointed by the Office of the
16 United States Trustee in these chapter 11 Cases.

17 **B. Historical Challenges.**

18 11. The Hospitals and VMF were originally owned and operated by the Daughters of
19 Charity of St. Vincent de Paul, Province of the West (the “Daughters of Charity”), to support the
20 mission of the Catholic Church through a commitment to the sick and poor. The Daughters of
21 Charity began their healthcare mission in California in 1858 and they ministered to ill, poverty-
22 stricken individuals for more than 150 years. In March 1995, the Daughters of Charity merged
23 with Catholic Healthcare West (“CHW”). In June 2001, Daughters of Charity Health System
24 (“DCHS”) was formed, and in October 2001, the Daughters of Charity withdrew from CHW. In
25 2002, DCHS commenced operations and was the sole corporate member of the Hospitals, which
26 at that time were California nonprofit religious corporations.

27 12. Between 1995 and 2015, the Daughters of Charity and DCHS struggled to find a
28 solution to continuing operating losses, either through a sale of some or all of the hospitals or a

1 merger with a more financially sound partner. All these efforts failed. During these efforts,
2 however, the health system's losses continued to mount, and the system borrowed more than
3 \$500 million – including through a 2008 bond issuance (the “2008 Bonds”) – to fund operations,
4 acquire assets, fund needed capital improvements and/or refinance existing debt.

5 13. Despite continuous efforts to improve operations, operating losses continued to
6 plague the health system due to, among other things, mounting labor costs, low reimbursement
7 rates and the ever-changing healthcare landscape. In 2013, DCHS actively solicited offers for
8 OCH, SLRH, SMC and SMCC. In 2013, to avoid failing debt covenants, the Daughters of
9 Charity Foundation, an organization separate and distinct from DCHS, donated \$130 million to
10 DCHS to allow it to retire the 2008 Bonds in the total amount of \$143.7 million.

11 14. In early 2014, DCHS announced that they were beginning a process to evaluate
12 strategic alternatives for the health system. Throughout 2014, DCHS explored offers to sell their
13 health system and, in October of 2014, they entered into an agreement with Prime Healthcare
14 Services and Prime Healthcare Foundation (collectively, “Prime”) to sell the health
15 system. However, to keep the hospitals open, DCHS needed to borrow another \$125 million to
16 mitigate immediate cash needs during the sales process; in other words, to allow DCHS to
17 continue to operate until the sale could be consummated. In early 2015, the California Attorney
18 General consented to the sale to Prime, subject to conditions on that sale that were so onerous that
19 Prime terminated the transaction.

20 15. In 2015, DCHS again marketed their health system for sale, and, again, focused on
21 offers that maintained the health system as a whole, and assumed all the obligations. In July
22 2015, the DCHS Board of Directors selected BlueMountain Capital Management LLC
23 (“BlueMountain”), a private investment firm, to recapitalize its operations and transition
24 leadership of the health system to the new Verity Health System (the “BlueMountain
25 Transaction”).

26 16. In connection with the BlueMountain Transaction, BlueMountain agreed to make a
27 capital infusion of \$100 million to the hospital system, arrange loans for another \$160 million to
28 the health system, and manage operations of the health system, with an option to buy the health

1 system at a future time. In addition, the parties entered into a System Restructuring and Support
2 Agreement (the “Restructuring Agreement”), DCHS’s name was changed to Verity Health
3 System, and Integrity Healthcare, LLC (“Integrity”) was formed to carry out the management
4 services under a new management agreement.

5 17. On December 3, 2015, the California Attorney General approved the
6 BlueMountain Transaction, subject to conditions. Despite BlueMountain’s infusion of cash and
7 retention of various consultants and experts to assist in improving cash flow and operations, the
8 health system did not prosper.

9 18. In July 2017, NantWorks, LLC (“NantWorks”) acquired a controlling stake in
10 Integrity. NantWorks brought in a new CEO, CFO, and COO. NantWorks loaned another \$148
11 million to the Debtors.

12 19. Despite the infusion of capital and new management, it became apparent that the
13 problems facing the Verity Health System were too large to solve without a formal court
14 supervised restructuring. Thus, despite VHS’ great efforts to revitalize its Hospitals and
15 improvements in performance and cash flow, the legacy burden of more than a billion dollars of
16 bond debt and unfunded pension liabilities, an inability to renegotiate collective bargaining
17 agreements or payor contracts, the continuing need for significant capital expenditures for seismic
18 obligations and aging infrastructure, and the general headwinds facing the hospital industry, make
19 success impossible. Losses continue to amount to approximately \$175 million annually on a cash
20 flow basis.

21 20. Additional background facts on the Debtors, including an overview of the Debtors’
22 business, information on the Debtors’ capital structure and additional events leading up to these
23 chapter 11 cases, are contained in the Adcock Declaration.

24 **C. Relevant Background to Motion**

25 1. The Debtors’ Employees

26 21. As set forth in the concurrently filed Adcock Declaration, altogether, the Debtors
27 employ approximately 7,385 employees – 6,907 excluding VMF and 478 under VMF. For W-2
28 tax and payroll purposes, the Debtors are divided into eight employers:

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(a) VHS, which covers the Systems Office and the Philanthropic Foundations, and as of the Petition Date employed approximately 294 employees (the “VHS Employees”), of which 289 are full-time, 3 are part-time and 2 are employed on a “*per diem*” basis;

(b) VBS, which as of the Petition Date employed approximately 307 employees (the “VBS Employees”), of which 285 are full-time, 11 are part-time and 11 are *per diem*;

(c) OCH, which as of the Petition Date employed approximately 1,370 employees (the “OCH Employees”), of which 586 are full-time, 441 are part-time and 343 are *per diem*;

(d) SLRH, which as of the Petition Date employed approximately 480 employees (the “SLRH Employees”), of which 153 are full-time, 159 are part-time and 168 are *per diem*;

(e) SFMC, which as of the Petition Date employed approximately 2,017 employees (the “SFMC Employees”), of which 1,583 are full-time, 136 are part-time and 298 are *per diem*;

(f) SVMC, which as of the Petition Date employed approximately 1,099 employees (the “SVMC Employees”), of which 897 are full-time, 42 are part-time and 160 are *per diem*;

(g) SMC, which includes SMCC, and as of the Petition Date employed approximately 1,340 employees (the “Seton Employees,” and together with the VHS Employees, VBS Employees, OCH Employees, SLRH Employees, SFMC Employees and SVMC Employees, the “Verity Employees”), of which 516 are full-time, 551 are part-time and 273 are *per diem*; and

(h) VMF, which as of the Petition Date employed approximately 478 employees (the “VMF Employees,” and together with the Verity Employees, the “Employees”), of which 424 are full-time, 15 are part-time and 39 are *per diem*.

22. Both full-time and part-time (“core”) employees are regularly scheduled to work every pay period whereas *per diem* employees are used on an as-needed basis. *Per diem* employees are called in whenever Hospitals would not otherwise meet their core staffing requirements – for example, when core employees are sick or on vacation, or there is a spike in patient census. Although not limited to nursing employees, notably California requires the Hospitals to maintain specific nurse-to-patient ratios,⁵ so the Debtors use *per diem* employees to ensure the Hospitals are in compliance with those requirements.

⁵ See Cal. Health & Safety Code § 1276.4; Cal. Code Regs. tit. 22, § 70217.

1 2. Employee Unions

2 23. Almost three-quarters of the Debtors' Employees – approximately 5,488
3 Employees in total – are represented by unions (the "Represented Employees"). These
4 Represented Employees are represented by the California Nurses Association ("CNA");
5 Engineers and Scientists of California IFPTE Local 20, SEIU-UHW United Healthcare Workers-
6 West; California Licensed Vocational Nurses' Association; CLVNA United Nurses Associations
7 of California, UNAC, National Union of Healthcare Workers, NUHW; and The International
8 Union of Operating Engineers, Stationary Local No. 39, AFL-CIO ("Local 39 Stationary
9 Engineers," and collectively, the "Unions"). The Debtors' contractual arrangements with the
10 Unions regarding the employment of the Represented Employees are reflected in multiple
11 collective bargaining agreements (the "CBAs").

12 **D. Prepetition Wages, Payroll and Associated Benefits**

13 24. The Employees are paid their wages and salaries (the "Wages") bi-weekly, in
14 arrears, either five or six days after the end of every 14-day pay period, through direct deposit or
15 by check. The Debtors' average bi-weekly gross payroll is approximately \$25,394,994, which
16 includes approximately \$463,907 for executive payroll, \$3,726,816 for withholding obligations
17 (relating to various taxes, claims and other obligations) and \$208,476 for retirement plan
18 contribution matching.

19 25. Pursuant to LBR 2014-1(a), the Debtors intend to serve Notices of
20 Setting/Increasing Insider Compensation with respect to any of its executives who qualify as
21 "insiders" (as defined in § 101(31)). As part of this Motion, the Debtors seek authority to pay
22 these insider Employees the unpaid wage or salary obligations that have accrued on their behalf
23 prior to the Petition Date, provided that no objections to the Notices are received within the 15-
24 day time period provided by LBR 2014-1(a).

25 1. The Verity Debtors' Direct, Bifurcated, Payroll System

26 26. The Debtors are organized into eight employers. In addition, for payroll and cash
27 management purposes, the Debtors are separated into VMF and the rest of the Debtors (the latter,
28 the "Verity Debtors"). The Verity Debtors' payroll is further bifurcated, creating a constant pay

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1 cycle, with VBS, SFMC and Seton (collectively, “Verity Debtor Group A”) paying their
2 Employees on the odd weeks (e.g., 1, 3, . . . 49, 51), and VHS, OCH, SLRH and SVMC
3 (collectively, “Verity Debtor Group B”) paying their Employees on the even weeks (e.g., 2, 4, . . .
4 50, 52), in each case on a Friday – with the exception of SFMC whose payroll is processed on
5 Thursday – for the preceding 14-day pay period running from Sunday to Saturday. The Verity
6 Debtors process payroll directly, using a payroll platform licensed by Infinium. The Verity
7 Debtors normally transfer funds from their respective accounts payable bank accounts to their
8 respective payroll accounts two days prior to the pay date (i.e., Tuesdays for SFMC and
9 Wednesdays for the other Verity Debtors).⁶

10 27. The date on which the Employees of Debtor Group A and certain Employees of
11 Debtor Group B were last paid was August 30, 2018 for the two-week period ending August 25,
12 2018. The Employees of Debtor Group A represented by SEIU are entitled to identify and
13 resolve any errors in payroll within 24 hours (the “SEIU Lookback”). The Debtor Group A
14 Employees’ next routine payroll is scheduled for September 13 (for SFMC) and September 14,
15 2018 (the “September 13/14th Payroll”), and expected to include approximately \$24,287,614,
16 which covers Debtor Group A Wages earned from August 26, 2018 through September 8, 2018 –
17 approximately \$2,727,235 of which amount is attributable to prepetition Wages (the “Group A
18 Prepetition-Accrued Payroll”).

19 28. The date on which the remaining Employees of Debtor Group B were last paid
20 was August 24, 2018 for the two-week period ending August 18, 2018. These Employees’ next
21 routine payroll is scheduled for September 7, 2018 (the “September 7th Payroll”), and expected to
22 be approximately \$23,140,020, which covers Debtor Group B Wages earned from August 19,
23 2018 through September 1, 2018 – approximately \$11,560,517 of which amount is attributable to
24 prepetition payroll (together with the Group A Prepetition-Accrued Payroll, the “Verity Debtors
25 Prepetition-Accrued Payroll”).

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27 ⁶ By separate and contemporaneous motion, the Debtors are requesting authority to continue operating their cash
28 management system in the ordinary course of business, which, among other things, would permit them to continue
transferring funds between bank accounts to fund payroll.

1 29. Accordingly, the Debtors seek authority to pay the Verity Debtors Prepetition-
2 Accrued Payroll in the amount of \$14,287,752 on account of prepetition Wages, which they
3 confirm does not exceed \$12,850 per Employee. The Debtors further seek to pay any additional
4 amounts identified as of the Petition Date through the SEIU Lookback. The Debtors further seek
5 to continue to pay Wages to the Employees of the Verity Debtors incurred postpetition in the
6 ordinary course of the Debtors' business.

7 2. VMF's Third-Party-Processed Payroll System

8 30. VMF pays the VMF Employees on the even weeks, on Fridays for the preceding
9 14-day pay period running from Monday to Sunday. VMF's payroll is disbursed by ADP, a
10 supplier of human resources and document services that provides VMF with payroll management
11 and administration services. VMF normally funds its payroll to ADP on Tuesday prior to the pay
12 date.

13 31. The date on which the VMF Employees were last paid was August 24, 2018 for
14 the two-week period ending August 19, 2018. These Employees' next routine payroll is also
15 scheduled for September 7, 2018 (the "September 7th ADP Payroll"), and expected to be
16 approximately \$1,147,594, which covers VMF Wages earned from August 20 through September
17 2, 2018 – approximately \$1,065,623 of which amount is attributable to prepetition Wages (the
18 "VMF Prepetition-Accrued Payroll," and together with the Verity Debtors Prepetition-Accrued
19 Payroll, the "Prepetition-Accrued Payroll"), which they confirm does not exceed \$12,850 per
20 Employee. VMF would need to fund the VMF Prepetition-Accrued Payroll to ADP by
21 September 4, 2018.

22 32. As of the Petition Date, VMF will owe ADP approximately \$4,500 with respect to
23 its processing of the VMF payroll and related payroll administration matters (the "Administration
24 Fees"). The Debtors request authority to continue to pay ADP the prepetition amount of \$4,500
25 and to pay the postpetition ADP Administration Fees in the ordinary course of VMF's business.

26 33. Accordingly, the Debtors seek authority to pay the VMF Prepetition-Accrued
27 Payroll in the amount of \$1,065,623 on account of prepetition Wages. The Debtors further seek
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1 to continue to pay Wages to the VMF Employees incurred postpetition in the ordinary course of
2 the Debtors' business.

3 3. The Debtors' Withholding Obligations

4 34. In the ordinary course of their business, the Debtors routinely withhold from the
5 Wages certain amounts that the Debtors are required to transmit to the government and certain
6 third parties for purposes such as Social Security and Medicare withholdings, federal and state or
7 local income taxes, contributions to the Debtors' benefit plans, savings and retirement plan
8 contributions, union claims, garnishment, child support or other similar obligations pursuant to
9 court order or law (collectively, the "Withholding Obligations"). The Debtors owe approximately
10 \$3,726,816 for Withholding Obligations – including payments for tax obligations (the "Employer
11 Tax Obligations") such as FICA and Social Security – in connection with the Requested
12 Prepetition Payroll. Accordingly, the Debtors seek authority to pay the prepetition Withholding
13 Obligations in the amount of \$3,726,816 on account of prepetition Wages; and to continue to pay
14 Withholding Obligations incurred postpetition in the ordinary course of the Debtors' business.

15 4. The Debtors' Union Obligations

16 35. In addition to various benefits incorporated above, the Debtors are required to
17 make certain Union-specific contributions (the "Union Obligations"). Specifically, the Debtors
18 are required to contribute 0.022% of the wages of the Represented Employees with SEIU-UHW
19 to the SEIU Training and Upgrade Fund; this payment is made annually in February, and is not
20 currently owing. The Debtors are also required to make a monthly contribution of approximately
21 \$165,800 (on average, in Calendar Year 2018) to the Local 39 Pension Trust Fund on behalf of
22 Represented Employees with Local 39 Stationary Engineers. Accordingly, the Debtors seek
23 authority to pay the prepetition Union Obligations in the amount of \$176,524 on account of
24 prepetition Wages; and to continue to pay Union Obligations incurred postpetition in the ordinary
25 course of the Debtors' business.

26 **E. Business Expense Reimbursements**

27 36. The Debtors customarily reimburse Employees who incur business expenses in the
28 ordinary course of performing their duties on behalf of the Debtors. Such expenses typically

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1 include, but are not limited to, business-related travel expenses (including mileage), business
2 meals, relocation allowances, tuition reimbursement, and other items specified in the CBAs (the
3 “Reimbursement Obligations”). Expense reports detailing the Reimbursement Obligations are
4 submitted for reimbursement by the Employees and generally must be supported by copies of
5 receipts.

6 37. It is difficult for the Debtors to determine the exact amount of Reimbursement
7 Obligations that is due and owing for any particular time period since the expenses incurred by
8 Employees on behalf of the Debtors throughout the year vary on a monthly basis and because
9 there may be some delay between when an Employee incurs an expense and submits the
10 corresponding expense report for processing. Based on historical experience, the Debtors
11 anticipate that, as of the Petition Date, the Debtors owe an estimated \$30,200 in Reimbursement
12 Obligations. Accordingly, the Debtors seek authority to pay \$30,200 in Reimbursement
13 Obligations to their Employees. The Debtors further seek to continue to pay Reimbursement
14 Obligations incurred postpetition in the ordinary course of the Debtors’ business.

15 **F. Bonuses**

16 38. Certain Employees are eligible to receive sign-on and retention bonuses (the
17 “Bonuses”). Sign-on bonuses are provided to candidates for employment in hard-to-fill or critical
18 vacancies, such as ICU or Surgery Registered Nurses. Sign-on and retention bonuses are
19 provided for management candidates as a recruiting incentive and to guarantee high-quality
20 management candidates remain with the organization for a specified period of time.

21 39. The Debtors are not, by this Motion, seeking permission to pay any Bonuses to
22 continuing Employees but do seek the authority, in the Debtors’ discretion, to pay the Employees
23 for contractually agreed bonuses that accrued within the 180 days prior to the Petition Date when
24 their services with the Debtors are terminated so long as the total of the payments already then
25 made for prepetition Employee Obligations and the Bonuses does not exceed the statutory limit
26 for priority claims of \$12,850.

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1 **G. Paid Time Off and Extended Sick Leave**

2 40. Full-time and part-time Employees become eligible to receive employment
3 benefits beginning the first of the month following 30 days of employment (when they become
4 “Eligible Employees”). *Per diem* Employees are not Eligible Employees.

5 41. The Debtors provide Eligible Employees with Paid Time Off (“PTO”) and
6 Extended Sick Leave (“ESL”). PTO is time off due to vacation, holiday, personal or incidental
7 sick time. ESL kicks in (a) immediately where the Eligible Employee is admitted for surgery, (b)
8 after a 3-day waiting period for a workers’ compensation injury, and (c) after a 7-day waiting
9 period if workers’ compensation is not implicated.

10 42. Eligible Employees accrue PTO and ESL annually, and the number of hours they
11 can accrue increases in successive years.⁷ When these various caps are reached, no further PTO
12 or ESL, respectively, will accrue until the Employee uses some of the accrued Paid PTO or some
13 of the accrued time is cashed out by the Employee (per the terms of the relevant CBA or Hospital
14 or Systems Office policy). As of the Petition Date, the Debtors are carrying approximately \$36.6
15 million on their books for 789,942 hours of accrued and unused PTO. Eligible Employees are
16 permitted to cash out their unused PTO on one or two occasions during the year depending on the
17 relevant Hospital or CBA. As of the Petition Date, the Debtors are carrying approximately \$17.5
18 million on their books for 372,000 hours of accrued and unused ESL. Some CBAs permit
19 Eligible Employees to cash out a portion of their unused ESL at retirement.

20 43. The Debtors seek authority to honor their existing PTO and ESL policies to the
21 extent it would permit continuing Employees to use their prepetition accrued leave in the ordinary
22 course of business, and going forward. The Debtors are not, by this Motion, seeking permission
23 to cash out any accrued and unused PTO or ESL of continuing Employees but do seek the
24 authority, in the Debtors’ discretion, to pay the Employees for unused PTO and/or ESL, as
25 permitted per Hospital policy and relevant CBA terms, that accrued within the 180 days prior to
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28 ⁷ The specific hours vary depending on the relevant CBA governing the Represented Employee’s employment.

1 the Petition Date so long as the total of the payments already then made for prepetition Employee
2 Obligations and the PTO/ESL does not exceed the statutory limit for priority claims of \$12,850.

3 **H. Employee Benefits**

4 44. The Debtors offer Eligible Employees the opportunity to participate in a number
5 of insurance and benefit programs, including, among other things, medical, dental and vision
6 plans, life insurance, short-term and long-term disability insurance, workers' compensation,
7 retirement plans and other insurance plans and benefits as described below (collectively, the
8 "Employee Benefits").

9 1. Medical, Vision and Dental Insurance

10 45. The Debtors offer all Eligible Employees and their eligible dependents
11 (collectively, the "Dependents") medical, dental and vision insurance, which are primarily self-
12 insured by the Debtors with the exceptions set forth below.

13 46. For medical, the Debtors offer (a) a self-insured Exclusive Provider Organization
14 ("EPO") plan; (b) a self-insured preferred provider organization ("PPO") plan (together with (a),
15 the "Self-Insured Medical Plans"); (c) one PPO plan fully-insured by Blue Shield of California
16 ("BlueShield") for the enrolled Represented Employees of SMC with CNA and their Dependents
17 (together with the Self-Insured Medical Plans, the "Medical Plans"). Healthnow is the third-party
18 administrator for all medical and prescription drug claims against the Self-Insured Medical Plans.

19 47. The Debtors bear between approximately 51% and 100% of the costs of the
20 Medical Plans. Depending on (a) which Debtor Employer, (b) whether the Eligible Employee is a
21 Represented Employee – and, if so, under which CBA, and (c) whether and how many
22 Dependents are covered, the Debtors' and Employees' respective monthly costs for the Medical
23 Plans fall within the following ranges:

Plan	Monthly Employer Cost	Monthly Employee Cost
EPO	\$539.19 - \$2,959.45	\$0 - \$214.65
PPO	\$403.32 - \$2,994.42	\$49.21 - \$1,136.83
BlueShield PPO	\$705.63 - \$2,187.46	\$326.56 - \$1,012.35

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1 48. The Self-Insured Medical Plans are on a self-bill model, whereby the Debtors pay
2 (a) to Healthnow: (i) monthly administration fees (including pass-through stop-loss insurance fees
3 to Voya) based on the number of insured Employees in the prior month and (ii) actual medical
4 claims; and (b) to BlueShield: accrued and unpaid prepetition premiums on account of the
5 BlueShield Plan. As of the Petition Date, the Debtors believe they do not owe any prepetition
6 administration fees to Healthnow, or prepetition premiums to BlueShield. As of the Petition
7 Date, the Debtors owed approximately \$3,162,816 to Healthnow on account of accrued and
8 unpaid prepetition claims against the Self-Insured Medical Plans.

9 49. For dental, the Debtors offer three self-insured Delta Dental plans and one Cigna
10 plan (together, the “Dental Plans”). The Debtors bear between approximately 45% and 100% of
11 the costs of the Dental Plans. Depending on the Employees’ Hospital and Union affiliation and
12 Dependent status, the Debtors’ and Employees’ respective monthly costs for the Dental Plans fall
13 within the following ranges:

Plan	Monthly Employer Cost	Monthly Employee Cost
Cigna DHMO	\$25.28 - \$69.90	\$0
DD 800	\$21.81 - \$95.52	\$0 - 47.67
DD 1200 with Ortho	\$43.64 - \$170.87	\$0 - \$93.99
DD 1500	\$30.41 - \$95.52	\$0 - \$101.68

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20 50. As of the Petition Date, the Debtors owed approximately \$48,060 to Cigna and
21 Delta Dental on account of accrued and unpaid prepetition claims against the Dental Plans. As of
22 the Petition Date, the Debtors believe they do not owe any prepetition administration fees to
23 Cigna or Delta Dental.

24 51. For vision, the Debtors offer two self-insured VSP plans (the “Vision Plans,” and
25 together with the Medical Plans and the Dental Plans, the “Health Plans”). The Debtors bear up
26 to 100% of the costs of the Vision Plans. Depending on the Employees’ Hospital and Union
27 affiliation and Dependent status, the Debtors’ and Employees’ respective monthly costs for the
28 Vision Plans fall within the following ranges:

Plan	Monthly Employer Cost	Monthly Employee Cost
VSP Basic	\$4.27 - \$20.88	\$0 - \$10.44
VSP Buy-Up	\$0 - \$20.87	\$6.41 - \$36.53

52. As of the Petition Date, the Debtors owed approximately \$60,150 to VSP on account of accrued and unpaid prepetition claims against the Vision Plans. As of the Petition Date, the Debtors believe they do not owe any prepetition administration fees to VSP.

53. The Debtors believe that they are current on the administration fees and premiums related to the Health Plans. To the extent they are not, however, the Debtors seek authority to pay their portion of any premiums or administration fees for the Health Plans that accrued and remain unpaid as of the Petition Date, and to turn over to BlueShield any amounts sufficient to satisfy the portion of the accrued and unpaid prepetition premiums to be paid by the Employees in connection with the payment of the Wages and Withholding Obligations. The Debtors also seek authority to continue to pay, in their discretion and in the ordinary course of their business, the administration fees, premiums for and claims under the Health Plans incurred postpetition.

54. Furthermore, and for similar reasons, the Debtors seek to continue to perform any obligations under § 4980B of the Internal Revenue Code to administer Continuation Health Coverage (“COBRA”) (*see* 26 U.S.C. § 4980B) in respect to former employees. The Debtors believe that any prepetition costs related to COBRA coverage benefits are *de minimis*, but nonetheless, to maintain Employee morale and ensure the orderly administration of the Estates, the Debtors request authority to pay in their discretion any such prepetition costs.

2. Employee Life, Disability and Workers’ Compensation

55. The Debtors offer Eligible Employees premium-based group life insurance (“Life Insurance”) and accidental death and dismemberment insurance (“AD&D”) through UNUM. The premiums and other related charges for life insurance are paid 100% by the Debtors up to 1x salary⁸ and total approximately \$193,647 monthly on account of approximately 5,900 Employees. The premiums and other related charges for AD&D coverage are paid 100% by the Debtors up to

⁸ Employees may elect to upgrade coverage to 5x annual salary and pay the additional amount themselves.

1 \$10,000⁹ and total approximately \$16,191 monthly on account of approximately 5,800
2 Employees.

3 56. The Debtors also offer Eligible Employees premium-based short term (“STD”)
4 and long term disability coverage (“LTD”) through Cigna. Depending on CBA, the Debtor
5 employer pays 40-50% of premiums and other related charges for LTD,¹⁰ and total approximately
6 \$108,035 and \$110,643 monthly, respectively, on account of 5,800 Employees. STD premiums
7 are 100% employee-funded.

8 57. The Debtors also provide workers’ compensation insurance through Old Republic
9 Insurance (the “Workers’ Compensation Insurance”). Their broker of record is Lockton. The
10 amount of the annual premium is approximately 2,044,515 which is paid quarterly in the amount
11 of approximately \$511,128. The Debtors use Sedgwick as their third-party administrator, whom
12 the Debtors pay an estimated annual fee of \$702,000, which the Debtors pay in quarterly
13 installments, in advance of each quarter, of approximately \$175,000.

14 58. In addition, as of the Petition Date, the Debtors owe approximately \$10,293 to
15 Cigna on account of claims under the Federal Medical Leave Act (FMLA) and California Family
16 Rights Act (CFRA); and \$13,507 to Optum under an employee assistance program.

17 59. The Debtors believe that they are current on all the above-mentioned insurance
18 policies and claims obligations. To the extent they are not, however, the Debtors seek authority,
19 in their discretion, to pay any accrued and unpaid prepetition premiums and related charges and to
20 continue the above benefits postpetition and to deliver the Employees’ portion of any accrued and
21 unpaid prepetition premiums to the corresponding administrators in connection with the payment
22 of the Wages and Withholding Obligations.¹¹

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25 ⁹ Employees may elect to upgrade coverage to 1x-4x annual salary and pay the additional amount themselves.

26 ¹⁰ Depending on CBA, some Employees may elect to upgrade coverage to 60%.

27 ¹¹ By separate and contemporaneous motion, the Debtors are requesting authority to maintain their insurance program
28 (including workers’ compensation policies) and pay insurance premiums, deductibles and administration fees in the
ordinary course of business (including any amounts accrued and unpaid as of the Petition Date). For the avoidance of
doubt, to the extent these two Motions overlap, the Debtors seek authority to pay any obligation only once.

1 3. Retirement Plans

2 60. The Verity Debtors also offer eligible Employees the opportunity to participate in
3 various retirement plans, including three defined benefit plans (Verity Health System Retirement
4 Plan A, Verity Health System Retirement Plan B, and the Retirement Plan for Hospital
5 Employees), each funded according to IRS rules and actuarial determinations, two employer-
6 funded defined contribution plans (Verity Health System Retirement Plan Account and Verity
7 Health System Supplemental Retirement Match Plan 401(a)¹²), and two defined contribution
8 plans funded by voluntary employee pre-tax payroll deferrals (Verity Health System
9 Supplemental Retirement Plan TSA/403(b)¹³ and Verity 457(b) Plan¹⁴ (“457(b) Plan”).

10 61. VMF offers its Represented Employees and non-represented Employees the
11 opportunity to participate in two defined contribution plans (Verity Medical Foundation 401(k)
12 Plan and Verity Medical Foundation Management Bargaining Unit Employees 401(k) Plan)
13 which allow for voluntary employee pre-tax deferrals, matching contributions and employer
14 provided contributions (together with the defined benefit plans, defined contribution plans, and
15 457(b) Plan, the “Retirement Plans”).

16 62. Employees participating in these programs may contribute up to the federal
17 statutory cap per year. The Debtors deduct the employee pre-tax deferrals from Employee
18 paychecks. The Debtors provide a match benefit for certain Employees of 50% up to 6% of
19 annual salary or 35% up to 5% of annual salary (under the Verity Health System plans) or 75%
20 up to 4% of the annual salary for Employees (under the VMF plans), provide formula-based
21 nondiscretionary defined contribution allocations, and contribute actuarially determined required
22 cash contributions to the defined benefit plans; the Debtors do not contribute to any other
23 Retirement Plans. Employee contributions are remitted immediately following each pay date.

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25 _____
26 ¹² The name of these plans comes from § 401(a) of the Internal Revenue Code (“IRC”), which provides for money
purchase type retirement plans for employees.

27 ¹³ The name of these plans comes from § 403(b) of the IRC, which provides for tax-sheltered retirement plans for
employees of certain 501(c)(3) tax-exempt organizations.

28 ¹⁴ The name of these plans comes from IRC § 457(b), which provides for non-qualified, tax-advantaged deferred
compensation retirement plans for employees of certain employers.

1 Failure to timely forward the Employees' Retirement Plan deductions may be a violation of the
2 Employee Retirement Income Security Act of 1974, as amended ("ERISA"), resulting in potential
3 personal liability for the Debtors' officers for such deducted amounts. The Debtors believe that
4 maintaining the Retirement Plans is critical to maintaining Employee morale. Furthermore,
5 certain of these retirement benefits are required by CBAs.

6 63. The Debtors seek authority to pay their matching contributions that accrued and
7 remain unpaid as of the Petition Date for the Retirement Plans and to deliver the Employee
8 contributions in connection with the payment of Wages and Withholding Obligations described
9 above. Administration fees for the defined contribution plans are paid by the Employee
10 participants while administration for the defined benefit plans are paid by the Debtors. The
11 Debtors also seek authority to continue to pay, in their discretion and in the ordinary course of
12 their business, matching contributions for the Retirement Plans incurred postpetition. The
13 Debtors do not believe these additional payments will increase the total of the payments already
14 then made for prepetition Employee Obligations to exceed the statutory limit for priority claims
15 of \$12,850; however, if that is not the case, the Debtors believe that any prepetition costs related
16 to these retirement benefits are *de minimis*, and the Debtors request authority to pay in their
17 discretion any such prepetition costs to maintain Employee morale and ensure the orderly
18 administration of the Estates.

19 4. Miscellaneous Employee Benefit Plans

20 64. The Debtors also offer their eligible Employees the opportunity to participate in an
21 IRS Section 125¹⁵ Cafeteria Plan through Alliant Choice Plus, which includes voluntary critical
22 care insurance, pet insurance, auto and home insurance. The healthcare reimbursement account
23 and dependent care reimbursement account are administered through Healthnow, and long-term
24 care is administered through UNUM. All of these programs are 100% funded by the Employees
25 and are paid for through payroll deductions. The Debtors request authority to continue to honor
26 these programs, in their discretion, and to continue distributing to third-parties the payments for

27 _____
28 ¹⁵ The name of these plans comes from IRC § 125, which provides for participating employees to choose among two or more qualified benefits (as defined in the IRC) that are excluded from income.

1 these programs in connection with the payment of Wages and Withholding Obligations as
2 described above, including the distributions of payments that are for prepetition amounts due.

3 **IV.**

4 **DISCUSSION**

5 Sections 105(a) and 363(b)(1) and (c)(1) and the “necessity of payment” doctrine provide
6 statutory support for the requested relief. Specifically, § 363(b)(1) of the Bankruptcy Code
7 authorizes a debtor in possession to use property of the estate other than in the ordinary course of
8 business after notice and a hearing; and § 363(c)(1) of the Bankruptcy Code authorizes a debtor in
9 possession to enter into transactions in the ordinary course of business without notice and a
10 hearing. LBR 2081-1(a)(6) also expressly permits a debtor to seek to pay prepetition employee
11 obligations.

12 Moreover, the Employee Obligations that the Debtors request authority to pay and/or
13 honor are entitled to priority in payment under §§ 507(a)(4), (5) and (8)(D). If the aggregate
14 prepetition Wages, Employee Benefits and PTO that accrued within the 180 days prior to the
15 Petition Date exceed the sum of \$12,850 allowable as a priority claim under §§ 507(a)(4) and (5)
16 for any individual Employee, the Debtors are not requesting, by this Motion, authority to pay any
17 such excess amounts. Thus, the Debtors request authority to pay or honor all Wages, Employee
18 Benefits and PTO in the ordinary course of business but only up to the \$12,850 priority cap for
19 each Employee.

20 **A. This Court Has Authority Pursuant to §§ 105(a)
and 363(b)(1) and (c)(1) to Grant the Relief Requested**

21 Pursuant to § 105(a), “the court may issue any order, process, or judgment that is
22 necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a). Essentially,
23 § 105(a) provides a statutory counterpart to the bankruptcy court’s otherwise inherent and
24 discretionary equitable powers. *See In re Sasson*, 424 F.3d 864, 874 (9th Cir. 2005); *In re*
25 *Halvorson*, 581 B.R. 610, 636 n.91 (Bankr. C.D. Cal. 2018).

26 Utilizing § 105(a), bankruptcy judges in this district have recognized the existence of:

27 some case law and some authority in the court’s rules in Rule 2081-
28 1(a)(6), which allows immediate payment of claims, often on first day

1 motions, based on the recognition of the critical need to pay prepetition
2 wage and commission claims to employees and specified independent
3 contractors so that they continue to work for the debtor and render services
to the debtor to help it continue operations as a going concern and to
reorganize in a Chapter 11 bankruptcy case.

4 *In re EcoSmart, Inc.*, Case No. 15-27139 (RK), 2015 WL 9274245, at *4 (Bankr. C.D. Cal. Dec.
5 18, 2015) (citing LBR 2081-1(a)(6) and 2 March, Ahart and Shapiro, *California Practice Guide:*
6 *Bankruptcy*, ¶ 11:386, at 11–45 (2014) (“Most courts allow payment of prepetition employee
7 wages up to the priority amount under the ‘necessity of payment’ doctrine, which permits
8 immediate payment of creditors who will not supply services or material essential to the conduct
9 of the business until their prereorganization claims are paid.”) (emphasis in original)).

10 Bankruptcy judges in this district routinely grant motions to pay prepetition wages that are
11 entitled to priority. *See, e.g., In re Gardens Reg’l Hosp. & Med. Ctr., Inc.*, Case No. 16-17463-
12 ER, Docket No. 68 (Bankr. C.D. Cal. June 10, 2016); *In re Gordian Med., Inc.*, Case No. 12-
13 12399-MW, Docket No. 57 (Bankr. C.D. Cal. March 5, 2012); *In re Victor Valley Cmty. Hosp.*,
14 Case No. 10-39537-CB, Docket No. 30 (Bankr. C.D. Cal. Sep. 17, 2010); *In re Downey Reg’l*
15 *Med. Ctr.-Hosp., Inc.*, Case No. 09-34714-BB, Docket No. 37 (Bankr. C.D. Cal. Sep. 17, 2009);
16 *In re Pleasant Care Corp.*, Case No. 07-12312-EC, Docket No. 47 (Bankr. C.D. Cal. Mar. 27,
17 2007). Courts either rely on the doctrine of necessity or a combination of § 507(a)(4) and LBR
18 2081-1(a)(6) to allow for the payment of prepetition employee wage claims up to the priority cap
19 set forth in § 507(a)(4). *EcoSmart*, 2015 WL 9274245, at *9. Thus, as long as the Debtors
20 “demonstrate . . . the priority status of wage, salary and commission claims of its employees and
21 independent contractors under 11 U.S.C. § 507(a)(4)(A) and (B),” such demonstration will
22 “warrant immediate payment in advance of general distribution on prepetition claims.” *Id.* That
23 is the extent of the relief the Debtors are requesting in this Motion.

24 The Debtors are mindful that in *In re B&W Enters.*, 713 F.2d 534 (9th Cir. 1983), the
25 Ninth Circuit refused to extend the “necessity of payment” doctrine beyond the railroad
26 reorganization case where the debtor made unauthorized postpetition payments to trade suppliers
27 on prepetition debts. In *B&W*, after conversion to chapter 7, the trustee sought to recover the
28 payments under § 549. That case is factually distinguishable from the instant one in that *B&W* (a)

1 involved ordinary trade suppliers for which the claims were not entitled to priority, (b) did not
2 seek prior court approval for the payments, and (c) was liquidating, thereby rendering the
3 “necessity” of such payments moot. Moreover, the U.S. Supreme Court, in *Czyzewski v. Jevic*
4 *Holding Corp.*, has recognized that courts “approve[] interim distributions that violate ordinary
5 priority rules,” generally when there are “significant Code-related objectives that the priority-
6 violating distributions serve,” including “payment of employees’ prepetition wages.” 137 S.Ct.
7 973, 985 (2017).

8 For a number of reasons, the Bankruptcy Code affords special treatment to certain
9 prepetition claims of employees. Compared to a typical claim in bankruptcy, wages represent a
10 large part of an employee’s wealth. In addition, unlike an ordinary trade creditor, the typical
11 employee does not have other sources of income and thus cannot diversify the risk of the
12 employer’s default.

13 Due to the timing of the commencement of these Cases, the Employees are owed accrued
14 prepetition Wages for which payment is due on September 7, 13 and 14, 2018. These Wages
15 cannot be paid without the approval of this Court. The failure of the Debtors to pay the Wages
16 timely in the ordinary course of their business would result in a blow to Employee morale that in
17 all likelihood would lead to employee turnover and other serious and irreparable disruptions of
18 the Debtors’ operations as well as possible harm to the Patients. Any significant number of
19 Employee departures or deterioration in morale, especially at this sensitive time, will substantially
20 and adversely impact the Debtors’ ability to operate the Hospitals and medical clinics and result
21 in immediate and irreparable harm to the Debtors’ estates.

22 The Debtors submit that the amounts to be paid pursuant to this Motion are comparatively
23 small in light of the importance and necessity of preserving the Employees’ services and morale
24 and the difficulties and losses the Debtors will suffer if Employee morale is low or if they leave in
25 significant numbers. The Debtors further submit that there is ample justification for their belief
26 that even the slightest delay in providing this relief to their Employees will hamper operations and
27 damage the Debtors’ estates. As a consequence, the Debtors are anxious to reassure their
28 Employees.

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1 Many Employees live from paycheck to paycheck and rely exclusively on receiving their
2 full compensation or reimbursement of their expenses in order to continue to pay their daily living
3 expenses. These Employees may be exposed to significant financial and healthcare related
4 problems if the Debtors is not permitted to pay and/or honor the Wages, PTO policy and
5 Employee Benefits, and the expenses associated therewith in the ordinary course of the Debtors'
6 business. It is critical, therefore, that the Debtors be permitted to pay outstanding,
7 non-discretionary prepetition Wages that would otherwise constitute priority claims against the
8 Debtors' estates, to honor their prepetition PTO policy regarding the use of accrued PTO and the
9 payment for it upon termination, and to continue to fund their Employee Benefits. To fail to do
10 so would be devastating to the Employees' morale and could lead to the loss of key Employees at
11 this critical time, which could impact Patient care.

12 Additionally, the Withholding Obligations do not constitute property of the Debtors'
13 Estates. They principally represent Employee earnings that governments (in the case of taxes),
14 Employees (in the case of voluntary Withholding Obligations) and judicial authorities (in the case
15 of involuntary Withholding Obligations), have designated for deduction from Employee
16 paychecks. The failure to transfer these withheld funds could result in hardship to certain
17 Employees and liability for the Debtors. The Debtors expects that if these Withholding
18 Obligations are not paid, the Debtors will receive inquiries from garnishors regarding the
19 Debtors' failure to submit, among other things, child support and alimony payments, which are
20 not the Debtors' property but, rather, have been withheld from Employee paychecks. Moreover,
21 if the Debtors cannot remit these amounts, the Debtors and their Employees may face legal action
22 due to the Debtors' failure to remit these payments.

23 **B. This Court Has Authority Pursuant to LBR 2081-1(a)(6) to Grant the Relief**
24 **Requested**

25 As discussed above, the LBR provide a roadmap toward the "immediate payment of
26 claims, often on first day motions, based on the recognition of the critical need to pay prepetition
27 wage and commission claims to employees . . . so that they continue to work for the debtor and
28 render services to the debtor to help it continue operations as a going concern and to reorganize in

1 a Chapter 11 bankruptcy case.” *EcoSmart*, 2015 WL 9274245, at *4; LBR 2081-1(a)(6). The
2 Debtors satisfy all the listed elements in these Cases:

3 The Employees are still employed by the Debtors. In satisfaction of LBR 2081-
4 1(a)(6)(A), the Wages the Debtors propose to pay are for Employees who are still employed by
5 the Debtors.

6 The proposed payments to Employees are absolutely necessary. In satisfaction of LBR
7 2081-1(a)(6)(B), albeit otherwise needless to say, it is essential for the Debtors to retain the
8 Employees to operate the Debtors’ business, particularly during this crucial beginning phase of
9 the Debtors’ Cases, where additional administration and other obligations are imposed upon the
10 Debtors. The Debtors are concerned that a failure to honor their payroll obligations will result in
11 Employees leaving their jobs, refusing to provide services to the Debtors – including essential
12 medical services to their Patients – and interfering with the administration of these Cases. As
13 opposed to the Debtors’ focusing their efforts on case administration, the Debtors would instead
14 be preoccupied with addressing dissatisfied Employee complaints. Without the Employees’
15 support, the Debtors’ business will be severely impaired, if not irreparably harmed.

16 These proposed payment procedures are beneficial to the Estates. The Debtors seek only
17 to honor the Employee Obligations which would constitute priority claims pursuant to § 507.
18 Such claims would otherwise be required to be paid prior to general unsecured claims in any
19 subsequent distribution of assets. However, if the Debtors do not honor such Employee
20 Obligations now, the Debtors run a serious risk of losing Employees, and the loss of Employees
21 would be severely detrimental to the Debtors’ business, which translates to a risk to the well-
22 being of the Patients, to any prospect of reorganization and to the Debtors’ goal of maximizing a
23 recovery for unsecured creditors. Accordingly, LBR 2081-1(a)(6)(C) is satisfied.

24 With the requested first-day relief, the Debtors’ prospect of reorganization is heightened.
25 With regard to LBR 2081-1(a)(6)(D), the Debtors’ prospect of reorganization is certainly higher
26 with the relief requested herein than without it.

27 The Debtors do not seek to pay any prepetition claims of any insiders at this time. In
28 satisfaction of LBR 2081-1(a)(6)(E), the Employees referenced herein are not insiders of the

1 Debtors. The Debtors are not requesting to pay anyone classified as an insider pursuant to this
2 Motion.

3 The Employees' claims are within the limits established by § 507 of the Bankruptcy Code.
4 In satisfaction of LBR 2081-1(a)(6)(F), the Debtors only seek authority to: (i) pay and/or honor
5 all prepetition Wages of the Employees; and (ii) honor accrued PTO and other Employee Benefits
6 in the ordinary course of business, provided that no Employee shall receive more than \$12,850 in
7 value on account of prepetition claims for Employee Obligations.

8 The proposed payments will not render the Estates administratively insolvent. Finally, in
9 satisfaction of LBR 2081-1(a)(6)(G), the source of the funds to be used to pay and/or honor the
10 prepetition Employee Obligations will be the Debtors' cash. The Debtors believe that their cash
11 is sufficient to pay the Wages without rendering their Estates administratively insolvent.

12 **C. The Prepetition Wages and Prepetition Employee Benefits Are**
13 **Priority Claims Under Bankruptcy Code §§ 507(a)(4) and (5)**

14 Pursuant to § 507(a)(4)(A), claims of Employees of the Debtors for “wages, salaries, or
15 commissions, including vacation, severance, and sick leave pay” earned within 180 days before
16 the Petition Date are afforded priority unsecured status to the extent of \$12,850 per Employee.
17 Similarly, § 507(a)(5) provides that Employees' claims for contributions to certain employee
18 benefit plans are also afforded priority unsecured status to the extent of \$12,850 per Employee
19 covered by such plan, less any amount paid pursuant to § 507(a)(4). The Debtors believes that
20 the Wages, PTO policy and Employee Benefits relating to the 180-day period prior to the Petition
21 Date constitute priority claims under §§ 507(a)(4) and (5). As priority claims, they must be paid
22 in full before any general unsecured obligations of the Debtors may be satisfied. Accordingly, the
23 relief requested may affect only the timing of the payment of these priority obligations and will
24 not prejudice the rights of general unsecured creditors or other parties in interest.

25 With respect to prepetition Wages, PTO policy and Employee Benefits, no Employees
26 will be paid on account of claims above the \$12,850 amount stated in §§ 507(a)(4) and (5) of the
27 Bankruptcy Code.
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1 **D. Maintaining the Employee Benefits Is Within the Debtors' Business Judgment**

2 The Debtors' relationships with the Employees, including the terms and conditions of
3 their employment, are matters subject to the Debtors' business judgment and may be managed by
4 the Debtors in the "ordinary course of business." See *In re All Seasons Indus.*, 121 B.R. 822,
5 825-26 (Bankr. N.D. Ind. 1990); *In re Pac. Forest Indus., Inc.*, 95 B.R. 740, 743 (Bank. C.D. Cal.
6 1989) ("Employees do not need court permissions to be paid and are usually paid as a part of the
7 ongoing operation of the business."). This doctrine also applies to accrued employee benefits
8 such as paid time off and leave policies. See *In re Canton Castings, Inc.*, 103 B.R. 874, 876
9 (Bankr. N.D. Ohio 1989). The maintenance of the Debtors' benefit programs is an important part
10 of the Debtors' relationships with their employees that is within the Debtors' business judgment.

11 Finally, the Withholding Obligations represent funds that the Debtors are not entitled to
12 hold for any protracted period, since the Debtors effectively holds these amounts in trust and the
13 Employees themselves hold a direct claim against such funds.

14 **E. Honoring of Checks and Transfers Related to Employee Obligations and
Maintenance of Payroll Accounts**

15 The Debtors further request that their bank be authorized and directed to receive, process,
16 honor and pay all checks presented for payment and to honor all transfer requests made by the
17 Debtors related to Employee Obligations, whether such checks were presented or funds transfer
18 requests were submitted prior to or after the Petition Date (including checks that have been
19 presented and dishonored), to the extent that the relevant accounts contain sufficient funds. The
20 Debtors will identify to the banks the checks that are to be honored pursuant to an order
21 approving this Motion. Accordingly, checks other than those for Employee Obligations should
22 not be honored inadvertently. Moreover, the Debtors expect to have sufficient funds to pay all
23 Employee Obligations, to the extent described herein, on an ongoing basis and in the ordinary
24 course of business.

25 **V.**

26 **CONCLUSION**

27 **WHEREFORE**, for all the foregoing reasons and such additional reasons as may be
28 advanced at or prior to the hearing on this Motion, the Debtors respectfully requests that this

1 Court enter an order: (i) authorizing the Debtors, in their discretion, to (a) pay or honor
2 prepetition wages, salaries, employee benefits, and other compensation, (b) remit withholding
3 obligations, (c) maintain workers' compensation and benefits programs, (d) pay related
4 administration obligations, and (e) pay reimbursable employee expenses; (ii) authorizing and
5 directing the applicable bank to pay all checks and electronic payment requests made by the
6 Debtors relating to the foregoing; and (iii) granting such other and further relief as is just and
7 proper under the circumstances.

8 Dated: August 31, 2018

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