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12 *Attorneys for U.S. Bank National Association, not individually*
13 *but as Series 2015 Note Trustee and Series 2017 Note Trustee, respectively*

14 **UNITED STATES BANKRUPTCY COURT**
15 **CENTRAL DISTRICT OF CALIFORNIA**
16 **LOS ANGELES DIVISION**

16 VERITY HEALTH SYSTEM OF
17 CALIFORNIA, INC., *ET AL.*,
18 Debtors.

Case 2:18-bk-20151-ER
Jointly Administered
Chapter 11 Cases

**COMBINED RESERVATION OF RIGHTS OF
U.S. BANK NATIONAL ASSOCIATION, AS
SERIES 2015 NOTE TRUSTEE AND SERIES
2017 NOTE TRUSTEE, TO DEBTORS'
EMERGENCY MOTION FOR ENTRY OF AN
ORDER AUTHORIZING DEBTORS TO
HONOR PREPETITION OBLIGATIONS TO
CRITICAL VENDORS**

McDERMOTT WILL & EMERY LLP
ATTORNEYS AT LAW
LOS ANGELES



1 U.S. Bank National Association, not individually but in its respective capacities as
2 Series 2015 Note Trustee (“*2015 Note Trustee*”) and Series 2017 Note Trustee (“*2017 Note*
3 *Trustee*” and together, the “*Notes Trustee*”), hereby submits this reservation of rights with
4 respect to the *Debtors’ Emergency Motion For Entry Of An Order Authorizing Debtors To*
5 *Honor Prepetition Obligations To Critical Vendors* [Docket No. 29] (the “*Motion*”) and
6 respectfully states as follows:

7 **I. JURISDICTION AND VENUE**

8 1. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and
9 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

10 2. Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

11 **II. BACKGROUND**

12 3. The 2015 Note Trustee represents the interests of the holders of the
13 \$160,000,000 California Public Finance Authority Revenue Notes (Verity Health System)
14 Series 2015 A, B, C, and D (collectively, the “*2015 Notes*”) and the 2017 Note Trustee
15 represents the interests of the \$42,000,000 California Public Finance Authority Revenue
16 Notes (Verity Health System) Series 2017 A and B (collectively, the “*2017 Notes*” and,
17 together with the 2015 Notes, the “*Notes*”).

18 4. The 2015 Notes were issued in four series pursuant to Indentures dated as of
19 December 1, 2015, and the 2017 Notes were issued in two series pursuant to Indentures dated
20 as of September 1, 2017 and December 1, 2017, each made by and between the Notes Trustee
21 as trustee and the California Public Finance Authority as issuer (the “*Authority*”).

22 5. The proceeds of each series of Notes were loaned to the Debtors pursuant to
23 (i) Loan Agreements dated as of December 1, 2015, with respect to the 2015 Notes, and (ii)
24 Loan Agreements dated as of September 1, 2017 and December 1, 2017, with respect to the
25 2017 Notes, each between the Authority and Verity Health System of California, Inc.
26 (“*VHS*”), for itself and as a representative of the Verity Health System Obligated Group under
27 the Master Indenture of Trust dated as of December 1, 2001, as supplemented (the “*Master*
28 *Indenture*”), between the Obligated Group and UMB Bank, N.A., as successor Master

1 Trustee.¹

2 6. The indebtedness evidenced by the Notes is jointly secured by senior first
3 priority security interests and liens on certain of the Debtors' assets, including (x) Accounts²
4 of St. Francis Medical Center, St. Vincent Medical Center, O'Connor Hospital, Saint Louise
5 Regional Hospital, and Seton Medical Center, including Seton Medical Center Coastside
6 (each a "*Hospital*" and collectively, the "*Hospitals*") and (y) real property and certain personal
7 property comprising St. Francis Medical Center and Saint Louise Regional Hospital
8 (collectively, the "*Senior Note Collateral*").³

9 7. The Notes are also jointly secured on a parity basis with the collateral pledged
10 to the other Obligations under the Master Indenture, including the Series 2005 Bonds.⁴ Those
11 Obligations are secured by, *inter alia*, (i) Deeds of Trust on the Hospitals and (ii) the "Gross
12 Revenues" of the Obligated Group, which is broadly defined to include "all revenues, income,
13 receipts and money received by or on behalf of the Members from all sources" (collectively,
14 the "*MTI Collateral*").⁵

15 _____
16 ¹ Capitalized terms used but not defined herein shall have the meanings given to them in the Motion. The
17 Obligated Group consists of VHS and the Hospitals.

18 ² "Accounts" includes, collectively, (a) any right to payment of a monetary obligation whether or not earned
19 by performance, that relates to or arises out of any services provided or goods rendered by an Obligated Group
20 Member (including, without limitation, payments made by or through a governmental authority to an
21 individual patient assigned to such Member), (b) without duplication, any 'account' (as defined in the Uniform
22 Commercial Code) ("*UCC*"), any accounts receivable, whether in the form of payments for services rendered
23 or goods sold, rents, license fees or otherwise, any Health-Care-Insurance Receivables and any Payment
24 Intangibles (each as defined in the UCC), (c) all General Intangibles, Intellectual Property (each as defined in
25 the UCC), rights, remedies, guarantees, supporting obligations and letter of credit rights relating to or arising
26 out of the foregoing assets described in clauses (a) and (b), (d) all information and data compiled or derived by
27 any Member or to which any Member is entitled in respect of or related to the foregoing assets described in
28 clauses (a) and (b) and (e) and all proceeds of any of the foregoing. *See* Amended and Restated Supplemental
Master Indenture Number 20 dated as of January 1, 2016, between VHS and the prior Master Trustee.

³ The Senior Note Collateral was pledged pursuant to (i) certain Security Agreements dated as of December 11,
2015 and Amended and Restated Security Agreements dated as of September 1, 2017, between the members of
the Obligated Group and the Notes Trustee and (ii) certain Deeds of Trust with Fixture Filing and Security
Agreement and Assignment of Leases and Rents dated as of December 11, 2015 and Amended and Restated
Deeds of Trust with Fixture Filing and Security Agreement and Assignment of Leases and Rents dated as of
September 15, 2017, by the members of the Obligated Group in favor of the Notes Trustee.

⁴ In addition to the Notes, the Obligations also include the California Statewide Communities Development
Authority Revenue Bonds (Daughters of Charity Health System) Series 2005A, F, G and H (the "*Series 2005
Bonds*").

⁵ *See* Master Indenture § 1.01 ("Gross Revenues" means all revenues, income, receipts and money received by
or on behalf of the Members from all sources, including (a) gross revenues derived from their operation and

1 8. Pursuant to that certain Intercreditor Agreement dated as of December 1, 2015,
2 as amended by the Amended and Restated Intercreditor Agreement dated as of September 1,
3 2017, as further amended by the Second Amended and Restated Intercreditor Agreement
4 dated as of December 1, 2017 (as amended, the “*Intercreditor Agreement*”), the Master
5 Trustee subordinated its liens and security interests, including the Gross Revenue pledge, to
6 the Notes Trustee with respect to the Senior Note Collateral.

7 9. The Senior Note Collateral and the MTI Collateral includes “cash collateral”
8 (the “*Cash Collateral*”) as defined in section 363(a) of Title 11 of the United States Code (the
9 “*Bankruptcy Code*”).

10 10. On August 31, 2018 (the “*Petition Date*”), VHS and the above-captioned
11 affiliated debtors (collectively, the “*Debtors*”), each filed a voluntary petition for relief under
12 chapter 11 of the Bankruptcy Code, commencing the above-captioned chapter 11 cases (the
13 “*Cases*”). Since the commencement of the Cases, the Debtors have been operating their
14 businesses as debtors in possession pursuant to §§ 1107 and 1108 of the Bankruptcy Code.
15 To date, no official committee or examiner has been appointed by the Office of the United
16 States Trustee in these Cases.

17 11. On the Petition Date, the Debtors filed the Motion seeking authority to
18 continue to pay and/or honor the claims of certain Critical Vendors in an interim amount of
19 up to \$5 million, and, after a final hearing, in an additional amount of up to \$15 million.

20 **III. RESERVATION OF RIGHTS**

21 12. In the Motion, the Debtors seek authority to continue to pay and/or honor
22 prepetition claims of certain Critical Vendors including Uncompensated Care and On-Call
23 Coverage Physicians, Medical Directors, Medical Leadership, Physician Educators, Medical

24 _____
25 possession of each Member's facilities; (b) gifts, grants, bequests, donations and contributions, exclusive of any
26 gifts, grants, bequests, donations and contributions to the extent specifically restricted by the donor to a
27 particular purpose inconsistent with their use for the payment of Required Payments; (c) proceeds derived from
28 (i) condemnation proceeds, (ii) accounts receivable, (iii) securities and other investments, (iv) inventory and
other tangible and intangible property, (v) medical reimbursement programs and agreements, (vi) insurance
proceeds and (vii) contract rights and other rights and assets now or hereafter owned by each Member; and (d)
rentals received from the lease of office space.”).

1 Services Providers, Medical Supplies and Equipment Providers, Clinical Staffing, Non-
2 Medical Services Providers, IT Services Providers, and Benefits Providers. The Motion seeks
3 immediate approval to pay such Critical Vendors an amount of up to \$5 million in aggregate
4 on an interim basis, which the Debtors claim is needed to avoid immediate and irreparable
5 harm.

6 13. The Notes Trustee acknowledges that the Debtors' business is complex and
7 that payment of certain vendors may be necessary to enhance the value of the bankruptcy
8 estates. However, payment of critical vendors is a form of extraordinary relief that is not
9 specifically authorized by any section of the Bankruptcy Code. If permitted, it will allow the
10 Debtors to use collateral pledged to the repayment of certain prepetition secured creditors,
11 like the Notes Trustee, to make payments to unsecured or other creditors whose claims may
12 otherwise be paid last. Further, the Debtors, at their discretion, can decide which Critical
13 Vendor claims should be paid and in what amounts. Accordingly, it is important to allow all
14 creditors sufficient time to understand how the Debtors' requests may impact creditors'
15 relative priorities and security positions.

16 14. As described above, the Senior Notes Collateral and MTI Collateral includes
17 Accounts and other collateral constituting Cash Collateral. Such Cash Collateral could
18 potentially be (a) used to make payments to Critical Vendors or (b) primed by super priority
19 liens granted in favor of any post-petition lender whose loan proceeds are used to pay Critical
20 Vendors. Accordingly, the Notes Trustee has a significant interest in making sure that interim
21 payments to Critical Vendors are only made where necessary to avoid immediate and
22 irreparable harm to the Debtors. Moreover, the Notes Trustee has an interest in understanding
23 the need for, and the proposed uses of, the additional up to \$15 million in potential Critical
24 Vendor payments that may be authorized on a non-interim basis. At this time, the Notes
25 Trustee does not expect to have a full understanding of these issue by the first day hearing on
26 the Motion.

27 15. The Notes Trustee is continuing to analyze the terms of the Motion as well as
28 the Debtors' proposed interim budget, and has engaged and will continue to engage in

1 discussions with the Debtors regarding the proposed amount and uses of funds sought by the
2 Motion. These discussions have been useful, and the Notes Trustee will continue its good
3 faith efforts to resolve its concerns through its ongoing dialogue and negotiation with the
4 Debtors and continued analysis and due diligence. Nonetheless, the Notes Trustee hereby
5 expressly reserves all of its rights, claims, objections, and remedies, including the right to
6 amend, modify, or supplement this Reservation of Rights, to seek discovery, to raise
7 additional objections and to introduce evidence at the interim and final hearings on the Motion,
8 on any grounds, as may be appropriate.

9 Dated: September 4, 2018

MCDERMOTT WILL & EMERY LLP

10 By: /s/ Jason D. Strabo

11 Jason D. Strabo

12 *Attorneys for U.S. Bank National Association, not*
13 *individually but as Series 2015 Note Trustee and*
14 *Series 2017 Note Trustee, respectively*

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PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is:

McDermott Will & Emery LLP
2049 Century Park East, 38th Floor
Los Angeles, CA 90067-3218

A true and correct copy of the foregoing document entitled COMBINED RESERVATION OF RIGHTS OF U.S. BANK NATIONAL ASSOCIATION, AS SERIES 2015 NOTE TRUSTEE AND SERIES 2017 NOTE TRUSTEE, TO DEBTORS' EMERGENCY MOTION FOR ENTRY OF AN ORDER AUTHORIZING DEBTORS TO HONOR PREPETITION OBLIGATIONS TO CRITICAL VENDORS will be served or was served (a) on the judge in chambers in the form and manner required by LBR 5005-2(d); and (b) in the manner stated below:

1. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF): Pursuant to controlling General Orders and LBR, the foregoing document will be served by the court via NEF and hyperlink to the document. On September 4, 2018, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

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This form is mandatory. It has been approved for use by the United States Bankruptcy Court for the Central District of California.

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Hatty K Yip on behalf of U.S. Trustee United States Trustee (LA)
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Service information continued on attached page

2. SERVED BY UNITED STATES MAIL:

On _____, I served [or will serve] the following persons and/or entities at the last known addresses in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

Service information continued on attached page

3. SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL (state method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on _____, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

Service information continued on attached page

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

September 4, 2018

/s/ Jason D. Strabo

Date

Jason D. Strabo

Signature

This form is mandatory. It has been approved for use by the United States Bankruptcy Court for the Central District of California.