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Debtors In Possession

**UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA - LOS ANGELES DIVISION**

In re

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

Debtors and Debtors In Possession.

- ☒ Affects All Debtors
☐ Affects Verity Health System of California, Inc.
☐ Affects O'Connor Hospital
☐ Affects Saint Louise Regional Hospital
☐ Affects St. Francis Medical Center
☐ Affects St. Vincent Medical Center
☐ Affects Seton Medical Center
☐ Affects O'Connor Hospital Foundation
☐ Affects Saint Louise Regional Hospital Foundation
☐ 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
☐ Affects De Paul Ventures, LLC
☐ Affects De Paul Ventures - San Jose Dialysis, LLC

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-20181-ER

Chapter 11 Cases

Hon. Ernest M. Robles

**DEBTORS' NOTICE AND MOTION FOR
APPROVAL OF COMPROMISE WITH
MEDLINE INDUSTRIES, INC. PURSUANT TO
FEDERAL RULE OF BANKRUPTCY
PROCEDURE 9019; DECLARATIONS OF
RICHARD G. ADCKOCK AND PETER C.
CHADWICK IN SUPPORT THEREOF**

Hearing:

Date: March 13, 2019

Time: 10:00 a.m.

Location: Courtroom 1568

255 E. Temple St., Los Angeles, CA



1820151190220000000000014

1 **PLEASE TAKE NOTICE** that at the above referenced date, time and location, Verity
2 Health System of California, Inc., a California nonprofit benefit corporation and the Debtor herein,
3 and the above-referenced affiliated debtors, the debtors and debtors in possession in the above-
4 captioned chapter 11 bankruptcy cases (collectively, the “Debtors”), will request approval of the
5 settlement agreement (the “Settlement Agreement”) between the Debtors, on the one hand, and
6 Medline Industries, Inc. (“Medline”).

7 Generally, the Settlement Agreement pertains to Medline’s pre-petition claims and the
8 Debtors’ and Medline’s ongoing business relationship. The Settlement Agreement provides for
9 the satisfaction of Medline’s claims and defines key terms of Medline and the Debtors’ post-
10 petition business relationship. The principal terms of the Settlement Agreement are set forth in the
11 accompanying Memorandum Of Points And Authorities (the “Memorandum”) and in full detail in
12 the Settlement Agreement attached hereto as **Exhibit A**. The Debtors submit that the Settlement
13 Agreement is in the best interests of the estate and should be approved.

14 **PLEASE TAKE FURTHER NOTICE** that this Motion is based on this Notice of Motion
15 and Motion, the Memorandum, the *Declaration of Richard G. Adcock in Support of First-Day*
16 *Motions*, filed August 31, 2018 [Dkt. No. 8], the attached Declaration of Richard G. Adcock and
17 Declaration of Peter C. Chadwick, supporting statements, arguments and representations of a
18 counsel who will appear at the hearing on the Motion, the record in this case, and any other
19 evidence properly brought before the Court in all other matters of which this Court may properly
20 take judicial notice.

21 **PLEASE TAKE FURTHER NOTICE** that any party opposing or responding to the
22 Motion must file and serve the response (“Response”) on the moving party and the United States
23 Trustee not later than 14 days before the date designated for the hearing. A Response must be a
24 complete written statement of all reasons in opposition thereto or in support, declarations and
25 copies of all evidence on which the responding party intends to rely, and any responding
26 memorandum of points and authorities.

1 **PLEASE TAKE FURTHER NOTICE** that, pursuant to LBR 9013-1(h), the failure to
2 file and serve a timely objection to the Motion may be deemed by the Court to be consent to the
3 relief requested herein.

4
5 Dated: February 20, 2019

DENTONS US LLP
SAMUEL R. MAIZEL
TANIA R. MOYRON

6
7
8 By /s/ Tania M. Moyron
Tania M. Moyron

9
10 Attorneys for Debtors and Debtors In
Possession

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MEMORANDUM OF POINTS AND AUTHORITIES

I.

INTRODUCTION

Pursuant to the Court’s Critical Vendor Order (defined herein), Verity Health System of California, Inc. (“VHS”) and the above-referenced affiliated debtors, the debtors and debtors in possession in the above-captioned chapter 11 bankruptcy cases (collectively, the “Debtors”), have settled their pre-petition exposure to Medline—one of their most important medical supply vendor—and ensured that Medline will continue to supply the Debtors with medical supplies on a go forward basis. As part of the agreement with Medline, the Debtors and Medline have agreed to a global resolution of Medline’s pre-petition claims against the Debtors. The Debtors believe that this agreement will aid in maintaining the Debtors’ valuable relationship with Medline during the chapter 11 cases, and potentially, preserving the relationship for a buyer of the Debtors’ assets. Based on the foregoing, and for the reasons set forth in greater detail below, the Debtors respectfully request that the Court approve this agreement.

II.

JURISDICTION

This Court has jurisdiction over this Motion under 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b) and may be heard and determined by the Bankruptcy Court. Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409. The statutory predicate for this Motion is 11 U.S.C. § 365(a).

III.

STATEMENT OF FACTS

A. General Background.

1. On August 31, 2018 (“Petition Date”), the Debtors each filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”).¹ Since the commencement of their cases, the Debtors have been operating their businesses as debtors in

¹ All references to “§” or “section” herein are to the Bankruptcy Code, 11 U.S.C. §§ 101, et seq., as amended.

1 possession pursuant to §§ 1107 and 1108.

2 2. Debtor VHS, a California nonprofit public benefit corporation, is the sole corporate
3 member of the following five Debtor California nonprofit public benefit corporations that operate
4 six acute care hospitals: O'Connor Hospital, Saint Louise Regional Hospital, St. Francis Medical
5 Center, St. Vincent Medical Center, Seton Medical Center, and Seton Medical Center Coastsides
6 (collectively, the "Hospitals") and other facilities in the state of California. *Declaration of*
7 *Richard G. Adcock in Support of First-Day Motions*, filed August 31, 2018 (the "First-Day Decl.")
8 [Dkt. No. 8], at 4, ¶ 11.

9 3. VHS, the Hospitals, and their affiliated entities (collectively, "Verity Health
10 System") operate as a nonprofit health care system, with approximately 1,680 inpatient beds, six
11 active emergency rooms, a trauma center, eleven medical office buildings, and a host of medical
12 specialties, including tertiary and quaternary care. *First-Day Decl.*, at 4, ¶ 12. On the Petition
13 Date, the Debtors had approximately 850 inpatients. *Id.* at 6, ¶ 17. The scope of the services
14 provided by the Verity Health System exemplified by the fact that in 2017, the Hospitals provided
15 medical services to over 50,000 inpatients and approximately 480,000 outpatients. *Id.*, at 4, ¶ 12.

16 4. On September 17, 2018, the Office of the United States Trustee appointed an
17 Official Committee of Unsecured Creditors in these chapter 11 Cases. [Dkt. No. 197.]

18 5. On December 27, 2018, the Court entered an *Order (A) Authorizing the Sale of*
19 *Certain of the Debtors' Assets to Santa Clara County Free and Clear of Liens, Claims,*
20 *Encumbrances, and Other Interests; (B) Approving the Assumption and Assignment of Unexpired*
21 *Lease Related Thereto; and (C) Granting Related Relief* [Dkt. No. 1153], which approved a sale
22 of O'Connor Hospital and Saint Louis Regional Hospital and related assets to Santa Clara County.

23 **B. Background Relevant To Motion.**

24 6. On the Petition Date, the Debtors requested Court authority to pay certain pre-
25 petition claims of suppliers and service providers (the "Critical Vendors") that are critical to
26 patient care and to avoid immediate and irreparable harm to the Debtors' operations. The Court
27 granted an interim order approving this relief on September 7, 2018 [Dkt. No. 134] and a final
28 order on October 9, 2018 [Dkt. No. 436] (the "Critical Vendor Order"). The Critical Vendor

1 Order authorizes the Debtors to pay prepetition claims of certain vendors in an aggregate amount
2 of up to \$20 million.

3 7. Medline Industries, Inc. (“Medline”) is a Critical Vendor of the Debtors with pre-
4 petition claims against the Debtors and which the Debtors continue to utilize in its cases.
5 Declaration of Richard G. Adcock (the “Adcock Declaration”), ¶ 4. The Debtors conducted
6 substantial prepetition business (including in the 20 days before the Petition Date) with Medline—
7 the largest privately held manufacturer and distributor of medical supplies in the country—and the
8 Debtors’ relationship with Medline is critical and substantial. *Id.*

9 8. The Debtors and Medline entered into two separate letter agreements (the “Critical
10 Vendor Letter Agreements”), pursuant to the Critical Vendor Order: (i) a critical vendor
11 agreement dated September 17, 2018, under which Medline agreed to continue to supply goods
12 and services to the Debtors on “Customary Trade Terms” in exchange for partial payment of
13 Medline’s agreed trade claim totaling \$3,535,025.00; and (ii) a critical vendor agreement, dated
14 November 27, 2018, under which Medline agreed to continue to provide services under the
15 Daughters of Charity Health System Master Purchase Agreement dated as of December 1, 2015
16 (as amended on May 1, 2017 to, among other things, substitute the Debtors for Daughters of
17 Charity Health System as a party) (the “TexCap Agreement”) in exchange for partial payment of
18 Medline’s agreed claim under the TexCap Agreement in the amount of \$314,167.72. Adcock
19 Declaration, ¶ 5. Payments to Medline under the Critical Vendor Letter Agreements totaled
20 \$1,126,950.00 (the “Critical Vendor Payments”). *Id.*

21 9. In addition to the Critical Vendor Payments, the Critical Vendor Letter Agreements
22 provide that the Debtors and Medline shall enter into a settlement agreement under, to be approved
23 by the Bankruptcy Court, to resolve matters related to the allowance and treatment of Medline’s
24 prepetition claims and any potential liability for avoidance actions under the Bankruptcy Code.
25 Adcock Declaration, ¶ 6.

26 **C. Settlement Agreement.**

27 10. In accordance with the terms of the Critical Vendor Letter Agreements, and in
28 order to resolve any disputes without extensive litigation, the Debtors and Medline have engaged

1 in settlement discussions and have reached an agreement (the “Settlement Agreement,” attached
2 hereto as Exhibit A). Adcock Declaration, ¶ 10.

3 11. In summary, the principal terms of the Settlement Agreement provide:²

4 (a) The Debtors agree that Medline holds a valid prepetition, unsecured claim in the
5 aggregate amount of \$3,849,192.72 (the “Aggregate Prepetition Claim”), which
6 amount includes an (i) unsecured claim in the aggregate amount of \$314,167.72 for
7 amounts due under the TexCap Agreement (the “TexCap Claim”), and (ii)
8 unsecured claim in the amount of \$3,535,025 for amounts due other than under the
9 TexCap Agreement (the “Non-TexCap Claim”). The Aggregate Prepetition Claim
10 amount also is partially comprised of a valid claim pursuant to Section 503(b)(9)
11 of the Bankruptcy Code in the amount of \$1,281,126 (the “Section 503(b)(9)
12 Claim”). The Aggregate Prepetition Claim shall be entitled to the following
13 treatment in the Debtors Bankruptcy Cases:

- 14 i. The Debtors and Medline agree the 503(b)(9) Claim shall be paid in full
15 upon the effective date of a plan of reorganization or earlier at the Debtors’
16 discretion.
- 17 ii. After deducting the Section 503(b)(9) Claim and the Payments from the
18 Aggregate Prepetition Claim, Medline shall have an allowed general
19 unsecured claim against the Debtors in the amount of \$1,331,116.72 (the
20 “Allowed GUC”).

21 (b) Medline will agree to provide the Debtors with net 45 day payment terms and
22 continue to satisfy supply requests on a timely basis (the “Supply Agreement”)
23 during the course of the Bankruptcy Case, subject to the terms of the Critical
24 Vendor Letter Agreements.

25 (c) Any and all avoidance actions and preference claims, including claims or causes of
26

27 ² This is a summary only. Reference should be made to the complete Settlement Agreement attached hereto as
28 Exhibit A. The terms of the Settlement Agreement shall control over the terms of this summary in all instances.

1 action pursuant to 11 U.S.C. § 547 and 548,³ are waived by the Debtors, their
2 bankruptcy estates, any and all successors, chapter 7 trustees, and any post-
3 confirmation creditor litigation trust.

4 (d) Neither party waives any rights under § 365 or any other rights and defenses to the
5 extent the TexCap Agreement or any other agreements between Medline and the
6 Debtors are deemed executory contracts.

7 (e) The parties agree that the Court has jurisdiction over any dispute arising from or
8 relating to the Settlement Agreement, the Critical Vendor Order, or Medline's
9 participation as Critical Supplier under the Critical Vendor Order.

10 **IV.**

11 **ARGUMENT**

12 The authority granted a trustee or debtor in possession to compromise a controversy or
13 agree to a settlement is set forth in Bankruptcy Rule 9019(a), which provides in pertinent part that
14 "[o]n motion by the [debtor in possession] and after hearing on notice to creditors [...], the court
15 may approve a compromise or settlement." "The bankruptcy court has great latitude in approving
16 compromise agreements" under its discretion. *See e.g., In re Woodson*, 839 F.2d 610, 620 (9th
17 Cir. 1988).

18 "The purpose of a compromise agreement is to allow the [debtor in possession] and the
19 creditors to avoid the expenses and burdens associated with litigating sharply contested and
20 dubious claims." *Martin v. Kane (In re A & C Properties)*, 784 F.2d 1377, 1380-81 (9th Cir.
21 1986), cert. denied 479 U.S. 854 (1986). Accordingly, in approving a settlement agreement, the
22 Court need not conduct an exhaustive investigation of the claims sought to be compromised. *See*
23 *United States v. Alaska Nat'l Bank (In re Walsh Constr., Inc.)*, 669 F.2d 1325, 1328 (9th Cir.

24
25
26 ³ Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-
27 1532, and all "Rule" references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037. All "LBR"
28 references are to the Local Bankruptcy Rules for the United States Bankruptcy Court for the Central District of
California.

1 1982). Rather, it is sufficient that the Court find that the settlement was negotiated in good faith
2 and is reasonable, fair, and equitable. *See In re A & C Properties*, 784 F.2d at 1381.

3 The Ninth Circuit has identified the following factors for consideration in determining
4 whether a proposed settlement agreement is reasonable, fair, and equitable:

- 5 (a) the probability of success in the litigation;
- 6 (b) the difficulties, if any, to be encountered in the matter of collection;
- 7 (c) the complexity of the litigation involved, and the expense, inconvenience, and
8 delay necessarily attending it; and
- 9 (d) the paramount interest of the creditors and a proper deference to their reasonable
10 views in the premises.

11 *In re A & C Properties*, 784 F.2d at 1381 (the “A & C Factors”).

12 A court should not substitute its own judgment for the judgment of the debtor in
13 possession. *Matter of Carla Leather, Inc.*, 44 B.R. 457, 465 (Bankr. S.D.N.Y. 1984). A court, in
14 reviewing a proposed settlement, is not to decide the numerous questions of law and fact but rather
15 to canvass the issues to determine whether the settlement falls below the lowest point in the range
16 of reasonableness. *In re W.T. Grant & Co.*, 699 F.2d 599, 608 (2nd Cir. 1983); *accord Newman v.*
17 *Stein*, 464 F.2d 689, 693 (2d Cir. 1972). The court should not conduct a “mini-trial” on the merits
18 of the underlying cause of action. *In re Walsh Const., Inc.*, 669 F.2d at 1328; *In re Blair*, 538 F.2d
19 849 (9th Cir. 1976). “It is well established that compromises are favored in bankruptcy.” *In re Lee*
20 *Way Holding Co.*, 120 B.R. 881, 891 (Bankr. S.D. Ohio 1990). In addition to the *A & C Factors*, it
21 is also well established that the law favors compromise. *In re Blair*, 538 F.2d at 851.

22 The Debtors believe that the Settlement Agreement is reasonable, fair and equitable and is
23 in the overwhelming best interests of the estates. Adcock Declaration, ¶ 12. A review of the *A & C*
24 *Factors* supports Court approval of the Settlement and Agreement as follows:

25 (a) **The probability of success in the litigation.**

26 In the course of negotiations regarding the Critical Vendor Letter Agreements, the Debtors
27 and Medline engaged in a review of their respective books and records to arrive at an agreement as
28 to correct amount of the Aggregate Prepetition Claim, the § 503(b)(9) Claim and Allowed GUC.

1 Adcock Declaration, ¶ 7. That review revealed that Medline provided supplies during the 20 day
2 period before the Petition Date with a value equal to the § 503(b) Claim. *Id.* The Debtors believe
3 Medline would be entitled to an allowed administrative priority claim in the amount of the §
4 503(b)(9) Claim. *Id.*

5 The Debtors likewise believe that the remaining Allowed GUC is a valid prepetition
6 unsecured claim and would not be disallowed. Adcock Declaration, ¶ 8. Moreover, the Debtors
7 have not identified material counterclaims or defenses to the Allowed GUC. *Id.* The fact is that
8 the Debtors have designated Medline as a Critical Vendor because Medline is an important, good
9 and reliable vendor for the Debtors. *See* Adcock Declaration, ¶ 4.

10 As part of the negotiations with the Medline the Debtors also conducted an analysis of the
11 prepetition transaction history between the parties to assess Medline's potential liability for
12 avoidance actions arising under Chapter 5 of the Bankruptcy Code. Declaration of Peter C.
13 Chadwick, ¶ 4. Medline made clear since the outset of the negotiations for a Critical Vendor
14 Letter Agreement that, in exchange for its agreement to continue to supply the Debtors, it expected
15 a full release of potential avoidance actions by the Debtors and their bankruptcy estates. *Id.* The
16 Debtors reviewed the transaction history between the parties to assess the potential economic
17 impact of such a waiver. *Id.* While the prepetition transaction history is substantial given the
18 amount of business the Debtors conducted with Medline, the Debtors' review of the payment
19 history revealed that most, if not all, of the payments received by Medline during the ninety day
20 "avoidance period" prior to bankruptcy would be protected by one or more defenses under § 547
21 and would not otherwise be subject to avoidance and recovery under the Bankruptcy Code. *Id.*
22 The Debtors further determined, in their business judgment, that whatever claims the estates may
23 be able to assert against Medline for avoidance and recovery of pre-petition payments did not
24 outweigh the benefits to the estates of Medline's continued supply and services, which are critical
25 to the Debtors' operations. Adcock Declaration, ¶ 9. Accordingly, the net benefits to the Debtors
26 and their estates under the Critical Vendor Letter Agreements and this Settlement Agreement
27 support approving the Settlement Agreement.

1 **(b) The difficulties, if any, to be encountered in the matter of collection.**

2 This factor is not relevant here as to the claims of Medline against the Debtors that are
3 being compromised. As to any claims that could be asserted against Medline by the Debtors, the
4 difficulty in collecting on any such claim that is ultimately determined in the Debtors' favor is
5 unknown.

6 **(c) The complexity of the litigation involved, and the expense, inconvenience, and**
7 **delay necessarily attending it.**

8 Medline is a major entity represented by able, sophisticated counsel who have actively
9 negotiated with the Debtors for the agreements set forth herein and in the Critical Vendor Letter
10 Agreements. In the course of those negotiations, the Debtors and Medline have agreed to the
11 Section 503(b)(9) Claim and the Allowed GUC. *See* Adcock Declaration, ¶ 10. Given that
12 Debtors have agreed to the proper amount of the claims, including agreement on more than \$3.5
13 million owed for the Aggregate Prepetition Claim, there is no further need to pay costs of
14 litigation which would have little chance of changing the agreed claims to be allowed under this
15 Settlement Agreement. Furthermore, any additional litigation over the Aggregate Prepetition
16 Claims and any claims of the Debtors against Medline would be fact and document intensive,
17 long, hard-fought, risky and expensive for small upside. The Settlement Agreement avoids those
18 potential costs while maintaining the strong relationship between the Debtors and Medline, which
19 also benefits the Debtors sale process.

20 **(d) The paramount interest of the creditors and a proper deference to their**
21 **reasonable views in the premises.**

22 The paramount interest of creditors strongly weighs in favor of approving the Settlement
23 Agreement. Generally, the fourth *A & C* Factor requires a court to take into account “not only the
24 desire of creditors to obtain the maximum possible recovery, but also their competing desire that
25 recovery occur in the least amount of time. This factor is thus interwoven with considerations of
26 expense, delay, and risk.” *In re Marples*, 266 B.R. 202, 207 (Bankr. D. Idaho 2001).

27 This Settlement Agreement is entered into with the spirit of the Critical Vendor Order -
28 which approved a process for VHS to satisfy the colorable pre-petition claims of select critical

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vendors (while remaining a fiduciary and using its business judgment) in order for VHS to continue to operate and bring in revenue and benefit the estate by preserving contractual and extra-contractual relationships with these critical vendors. Adcock Declaration, ¶ 11. The Debtors obtained the central concession of Medline to provide the Debtors with 45 days terms and to continue to satisfy supply requests on a timely basis. *Id.* As a hospital system in a very public bankruptcy, this is substantial to the Debtors—giving them repose, certainty through the replenishment of the lifeblood of medical supplies to the hospitals.

The Debtors wish to continue to utilize Medline. Adcock Declaration, ¶ 4. The Settlement Agreement not only limits and finalizes exposure, it furthers the Debtors' good relationship with an important Critical Vendor business partner, and potentially preserves that relationship for a purchaser of the Debtors' hospitals.

Here, the Debtors have mitigated risk by agreeing to a definite amount for the § 503(b)(9) Claim and the Allowed GUC. The Settlement Agreement also sets the definitive treatment of those claims in the Bankruptcy Cases. The Debtors have also mitigated risk by preserving § 365 rights to give the estate flexibility over any contracts going forward. Finally, Medline is an independent third party with no insider or personal connection to the Debtors except for their business relationship. *Cf. In re Woodson*, 829 F.2d 610 (9th Cir. 1988); Adcock Declaration, ¶ 4.

V.

CONCLUSION

Based on the foregoing, the Debtors request the (i) the entry of an order granting the Motion, and (ii) granting such other and further relief as is just and proper.

Dated: February 20, 2019

DENTONS US LLP
SAMUEL R. MAIZEL
TANIA R. MOYRON

By: /s/Tania M. Moyron
TANIA M. MOYRON

Attorneys for Debtors and Debtors In Possession

DECLARATION OF RICHARD G. ADCOCK

I, Richard G. Adcock, declare, that if called as a witness, I would and could competently testify thereto, of my own personal knowledge, as follows:

1. I am the Chief Executive Officer of Verity Health System of California, Inc. (“VHS”). I became the Debtors’ Chief Executive Officer effective January 2018. Prior thereto, I served as VHS’s Chief Operating Officer since August 2017.

2. Except as otherwise indicated herein, this Declaration is based upon my personal knowledge, my review of relevant documents, information provided to me by employees of the Debtors or the Debtors’ legal and financial advisors, or my opinion based upon my experience, knowledge, and information concerning the Debtors’ operations and the healthcare industry. If called upon to testify, I would testify competently to the facts set forth in this Declaration.

3. This Declaration is in support of the *Debtors’ Notice And Motion For Approval of Compromise With Medline Industries, Inc. Pursuant to Federal Rule of Bankruptcy Procedure 9019* (“Motion”) and for all other purposes permitted by law.

4. Medline Industries, Inc. (“Medline”) is the largest privately held manufacturer and distributor of medical supplies in the country. The Debtors conducted substantial pre-petition business (including in the 20 days before the date the Debtors’ bankruptcy cases were filed (the “Petition Date”)) with Medline and the Debtors’ relationship with Medline is critical and substantial. Medline also has pre-petition claims against the Debtors. The Debtors continue to utilize Medline’s business during these bankruptcy cases and the Debtors wish to continue to utilize Medline going forward. Thus, the Debtors have categorized Medline as a Critical Vendor. Medline is an important, good and reliable vendor for the Debtors. Medline is an independent third party with no insider or personal connection to the Debtors except for their business relationship.

5. The Debtors and Medline entered into two separate letter agreements (the “Critical Vendor Letter Agreements”), pursuant to the Critical Vendor Order: (i) a critical vendor agreement dated September 17, 2018, under which Medline agreed to continue to supply goods and services to the Debtors on “Customary Trade Terms” in exchange for partial payment of Medline’s agreed trade claim totaling \$3,535,025.00; and (ii) a critical vendor agreement dated

1 November 27, 2018 under which Medline agreed to continue to provide services under the
2 Daughters of Charity Health System Master Purchase Agreement dated as of December 1, 2015
3 (as amended on May 1, 2017 to, among other things, substitute the Debtors for Daughters of
4 Charity Health System as a party) (the “TexCap Agreement”) in exchange for partial payment of
5 Medline’s agreed claim under the TexCap Agreement in the amount of \$314,167.72. Payments to
6 Medline under the Critical Vendor Letter Agreements totaled \$1,126,950.00 (the “Critical Vendor
7 Payments”).

8 6. In addition to the Critical Vendor Payments, the Critical Vendor Letter Agreements
9 provide that the Debtors and Medline shall enter into a settlement agreement under, to be
10 approved by the Bankruptcy Court, to resolve matters related to the allowance and treatment of
11 Medline’s prepetition claims and any potential liability for avoidance actions under the
12 Bankruptcy Code.

13 7. In the course of negotiations regarding the Critical Vendor Letter Agreements, the
14 Debtors and Medline engaged in a review of their respective books and records to arrive at an
15 agreement as to correct amount of Medline’s Aggregate Prepetition Claim, the Section 503(b)(9)
16 Claim and Allowed GUC. That review revealed that Medline provided supplies during the 20 day
17 period before the Petition Date with a value equal to the Section 503(b) Claim. The Debtors
18 believe Medline would be entitled to an allowed administrative priority claim in the amount of the
19 Section 503(b)(9) Claim.

20 8. The Debtors likewise believe that the remaining Allowed GUC is a valid
21 prepetition unsecured claim and would not be disallowed. Moreover, the Debtors have not
22 identified material counterclaims or defenses to the Allowed GUC.

23 9. I determined, in my business judgment, that whatever claims the estates may be
24 able to assert against Medline for avoidance and recovery of pre-petition payments did not
25 outweigh the benefits to the estates of Medline’s continued supply and services, which are critical
26 to the Debtors’ operations.

27 10. In accordance with the terms of the Critical Vendor Letter Agreements, and in
28 order to resolve any disputes without extensive litigation, the Debtors and Medline engaged in

1 settlement discussions and reached an agreement (the "Settlement Agreement") as to the Section
2 503(b)(9) Claim and the Allowed GUC.

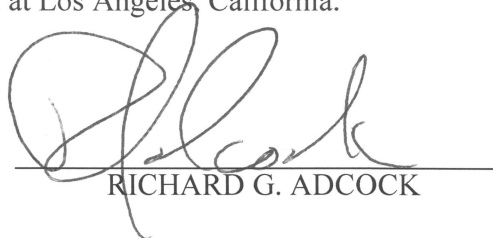
3 11. The Settlement Agreement was entered into with the spirit of the Critical Vendor
4 Order, which approved a process for VHS to satisfy the colorable pre-petition claims of select
5 critical vendors (while remaining a fiduciary and using its business judgment) in order for VHS to
6 continue to operate and bring in revenue and benefit the estate by preserving contractual and extra-
7 contractual relationships with these critical vendors. The Debtors obtained the central concession
8 of Medline to provide the Debtors with 45 days terms and to continue to satisfy supply requests on
9 a timely basis.

10 12. I believe that the Settlement Agreement is reasonable, fair and equitable and is in
11 the overwhelming best interests of the Debtors' estates.

12 I declare under penalty of perjury and of the laws in the United States of America, the
13 foregoing is true and correct.

14 Executed this 20th day of February, 2019, at Los Angeles, California.

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RICHARD G. ADCOCK

DECLARATION OF PETER C. CHADWICK

I, Peter C. Chadwick, declare, that if called as a witness, I would and could competently testify thereto, of my own personal knowledge, as follows:

1. I am a Managing Director of Berkeley Research Group, LLC (“BRG”) and am duly authorized to make this declaration (the “Declaration”) on behalf of BRG.

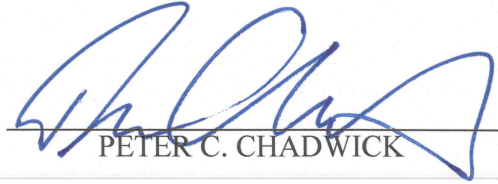
2. Except as otherwise indicated herein, this Declaration is based upon my personal knowledge, my review of relevant documents or information provided to me by employees of BRG. If called upon to testify, I would testify competently to the facts set forth in this Declaration.

3. This Declaration is in support of the *Debtors’ Notice And Motion For Approval of Compromise With Medline Industries, Inc. Pursuant to Federal Rule of Bankruptcy Procedure 9019* (“Motion”) and for all other purposes permitted by law.

4. As part of the negotiations with the Medline Industries, Inc., the Debtors also conducted an analysis of the prepetition transaction history between the parties to assess Medline’s potential liability for avoidance actions arising under Chapter 5 of the Bankruptcy Code. Medline made clear since the outset of the negotiations for a Critical Vendor Letter Agreement that, in exchange for its agreement to continue to supply the Debtors, it expected a full release of potential avoidance actions by the Debtors and their bankruptcy estates. The Debtors reviewed the transaction history between the parties to assess the potential economic impact of such a waiver. While the prepetition transaction history is substantial given the amount of business the Debtors conducted with Medline, the Debtors’ review of the payment history revealed that most, if not all, of the payments received by Medline during the ninety day “avoidance period” prior to bankruptcy would be protected by one or more defenses under Section 547 of the Bankruptcy Code and would not otherwise be subject to avoidance and recovery under the Bankruptcy Code.

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

Executed this 20th day of February, 2019, at Los Angeles, California.


PETER C. CHADWICK

DENTONS US LLP
300 SOUTH GRAND AVENUE, 14TH FLOOR
LOS ANGELES, CALIFORNIA 90071-3124
(213) 688-1000

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EXHIBIT A

EXHIBIT A

SETTLEMENT AGREEMENT

This Settlement Agreement (the “Agreement”) is entered into by and between the following parties (together, the “Parties”):

- A. Debtors: Verity Health System of California, Inc. and its affiliated debtors jointly administered under Bankruptcy Case No. 2:18-bk-20151-ER (Bankr. C.D. Cal.) (the “Debtors”), represented by its counsel, Dentons US LLP; and
- B. Vendor: Medline Industries, Inc. (“Medline”), represented by its counsel, Arent Fox LLP.

RECITALS

A. On August 31, 2018 (the “Petition Date”), the Debtors filed voluntary petitions for relief, thereby commencing their bankruptcy cases (the “Bankruptcy Cases”), under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”) in the United States Bankruptcy Court for the Central District of California (the “Bankruptcy Court”).

B. On the Petition Date, the Debtors filed a motion requesting the Bankruptcy Court’s authority to pay certain prepetition claims of suppliers and service providers (collectively, the “Critical Suppliers” and each a “Critical Supplier”) that are critical to patient care and to avoid immediate and irreparable harm to the Debtors’ operations. The Bankruptcy Court entered a final order (the “The Critical Supplier Order”) authorizing the Debtors, under certain conditions, to pay prepetition claims of Critical Suppliers in an aggregate amount up to \$20 million.

C. Medline has supplied the Debtors with medical goods prior to and since the Petition Date. In addition, Medline and the Debtors are parties to an agreement for textile processing and replacement under the Daughters of Charity Health System Master Purchase Agreement dated as of December 1, 2015 (as amended on May 1, 2017 to, among other things, substitute the Debtors for Daughters of Charity Health System as a party) (the “Tex Cap Agreement”).

D. Medline was deemed a Critical Supplier by the Debtors and has entered into agreements with the Debtors under the Critical Supplier Order, pursuant to which Medline has agreed to continue to supply goods and services to Debtors, including under the Tex Cap Agreement, in exchange for, among other things, payment of a portion of its Aggregate Pre-Petition Claim (defined below).

E. In connection with the negotiations for Medline’s status as a Critical Supplier, the Debtors and Medline have agreed that, in addition to the Payments (defined below), Debtors and Medline will resolve certain other matters relating to Medline’s claims for goods and services supplied prior to the Petition Date, the terms of which are incorporated herein.

NOW, THEREFORE, pursuant to the Critical Supplier Order and the agreements reached in connection therewith, and in consideration of the mutual covenants, agreements and promises set forth herein, and for other good and valuable considerations, the receipt and

sufficiency of which are hereby acknowledges, the Parties, intending to be legally bound as provided for herein, hereby agree as follows.

1. The Agreement.

1.1. The Debtors agree that Medline holds a valid prepetition, unsecured claim in the aggregate amount of \$3,849,192.72 (the “Aggregate Prepetition Claim”), which amount includes an (i) unsecured claim in the aggregate amount of \$314,167.72 for amounts due under the TexCap Agreement (the “TexCap Claim”) and (ii) \$3,535,025 for amounts due other than under the Tex Cap Agreement (the “Non-TexCap Claim”).

1.2. The Aggregate Prepetition Claim includes a valid administrative priority claim pursuant to Section 503(b)(9) of the Bankruptcy Code in the amount of \$1,281,126 (the “Section 503(b)(9) Claim”).

1.3. The Section 503(b)(9) Claim shall be an allowed administrative expense claim in the Bankruptcy Cases and paid upon the effective date of a plan of reorganization, or earlier at the Debtors’ discretion, and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Bankruptcy Court.

1.4. After deducting the Section 503(b)(9) Claim from the Aggregate Prepetition Claim, Medline holds a remaining prepetition general unsecured claim in the amount of \$2,568,066.72 (the “Remaining Prepetition Claim”). The Remaining Prepetition Claim shall subject to the following treatment:

- 1.4.1. In three separate payments, the Debtors have paid Medline \$1,236,950 of the Remaining Prepetition Claim (collectively, the “Payments”) as payments to a Critical Supplier pursuant to the Critical Supplier Order. In exchange for the Payments, Medline has agreed to continue to supply goods and services to Debtors during these Bankruptcy Cases on the terms and conditions set forth in this Agreement.
- 1.4.2. After deducting the Payments from the Remaining Prepetition Claim, Medline retains a general unsecured claim against the Debtors in the amount of \$1,331,116.72 (the “Allowed GUC”). The Allowed GUC shall be an allowed general unsecured claim in the Bankruptcy Cases pursuant to Section 502 of the Bankruptcy Code and subject to payment and treatment as such in any plan of reorganization approved in the Bankruptcy Cases and/or in accordance with the applicable provisions of the Bankruptcy Code and orders of the Bankruptcy Court.
- 1.4.3. Medline agrees that other than the claims included in the Aggregate Prepetition Claim, it holds no other prepetition claims against Debtors and agrees to be bound by the treatment of Aggregate Prepetition Claim as set forth in this Agreement. Except as provided herein, Medline shall not assert or prosecute against Debtors any prepetition claim other than the Allowed GUC and the Section 503(b)(9) Claim. Except for any unpaid portion of the Aggregate Prepetition Claim, Medline hereby expressly releases Debtors from any claims whatsoever arising

prior to the petition date, whether known, unknown, liquidated, unliquidated, contingent or otherwise.

1.5. During the Bankruptcy Cases, Medline agrees to continue to supply goods and services to Debtors on customary trade terms, practices and programs in existence between Medline and Debtors (including, but not limited to, credit limits, pricing, cash discounts, timing of payments, allowances, rebates, normal product mix and availability and other applicable terms and programs), which were most favorable to the Debtors and in effect between Medline and Debtors on a historical basis for the period within one-hundred eighty (180) days of the Petition Date (the “Customary Trade Terms”), except as set forth herein or as mutually agreed to by Debtors and Medline;

1.6. Notwithstanding any Customary Trade Terms to the contrary, Medline shall supply debtors during the course of the Bankruptcy Cases on net 45 day payment terms.

1.7. All avoidance actions and other causes of action arising under Chapter 5 of the Bankruptcy Code, including, but not limited to, claims or causes of action pursuant to Sections 547 and 548 of the Bankruptcy Code, are waived by the Debtors, their bankruptcy estates, any and all successors, chapter 7 trustees, and any post-confirmation creditor litigation trust.

1.8. Medline shall not file or otherwise assert against the Debtors, their estates or any other person or entity or any of their respective assets or property (real or personal) any lien (“Lien”) or claim for reclamation (“Reclamation Claim”), regardless of the statute or other legal authority upon which such Lien or Reclamation Claim may be asserted, related in any way to any remaining prepetition amounts allegedly owed to Medline by the Debtors arising from agreements or other arrangements entered into prior to the Petition Date and, to the extent Medline has already obtained or otherwise asserted such a Lien or Reclamation Claim, Medline shall take (at its own expense) whatever actions are necessary to remove such Lien or withdraw such Reclamation Claim unless and until its participation in the Critical Supplier protocol authorized by the Order is terminated or this agreement is terminated.

1.9. In the event of an assumption and/or assignment of the Medline contracts, whether pursuant to a sale of the Debtors’ assets or otherwise, neither party waives any rights under Section 365 of the Bankruptcy Code or any other rights and defenses.

1.10. If Medline voluntarily ceases to participate as a Critical Supplier pursuant to the Critical Supplier Order or otherwise is found by a final order of the Bankruptcy Court to be in breach of this Agreement, including by failure to supply Debtors on Customary Trade Terms, the Payments, or any portion thereof received by Medline, will be deemed to be a voidable postpetition transfers pursuant to Bankruptcy Code § 549(a) and Medline will immediately repay to the Debtors the Payments to the extent that the aggregate amount of such Payments exceeds any postpetition obligations then owing to Medline for goods and/or services provided under this Agreement, without the right of any setoffs, claims, provision for payment of reclamation or trust fund claims, or other defense

1.11. Notwithstanding Section 1.9 above, if the Debtors shall be in default under

this Agreement, Medline shall have no obligation to supply goods and/or services to the Debtors on Customary Trade Terms (as modified herein) until the Debtors cure such default and Medline shall have the right to terminate this Agreement upon written notice to the Debtors detailing the Debtors' defaults hereunder (which the Debtors shall have the right to dispute) and the Debtors failure to cure such default within five (5) business days of such notice, in which event Medline may retain the Payment and any other sums paid to it hereunder.

1.12. The Bankruptcy Court has jurisdiction over any dispute arising from or relating to this Agreement, the Critical Supplier Order, or Medline's participation as Critical Supplier under the Critical Supplier Order.

1.13. Except as to the claims and interests expressly preserved in this Agreement, the Parties acknowledge that there is a risk that subsequent to the execution of this Agreement, Medline will discover claims or incur or suffer loss, damage or injuries which are in some way caused by or related to the matters released herein, but which are unknown and unanticipated as of the execution date of this Agreement.

1.13.1. Medline hereby assumes the above-mentioned risks and acknowledges that this general release of claims SHALL APPLY TO ALL UNKNOWN OR UNANTICIPATED CLAIMS ARISING FROM THE MATTERS RELEASED HEREIN, AS WELL AS THOSE KNOWN AND ANTICIPATED.

1.13.2. Accordingly, Medline hereby expressly waives all its rights under Section 1542 of the California Civil Code as well as under any other statutes or common law principles of similar effect. For information, Section 1542 of the California Civil Code reads as follows:

A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH, IF KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS OR HER SETTLEMENT WITH THE DEBTORS.

1.13.3. Medline hereby represents, warrants and acknowledges that it has sought the advice of legal counsel of its choice with respect to this Agreement, this Section 1.13, and specifically with respect to the significance of its waiver of its rights under Section 1542 of the California Civil Code.

1.14. Nothing contained in this Agreement is intended or shall be deemed to release, waive or otherwise impair any claims of Medline or its successors or assigns, against: (1) any insurance carrier of Medline; and (2) any person or entity released by any of the parties to this Agreement to the extent they are acting in any capacity other than in connection to their business dealings with the Debtors. In addition, and for avoidance of doubt, nothing in this Agreement releases any person or entity not identified or described in this Agreement as being a person or entity receiving a release.

1.15. In the event that any party released hereunder asserts any released claim against any other released party, then any and all releases hereunder shall be null and void as to the asserting party.

2. Miscellaneous Provisions.

2.1. The Parties executing this Agreement do so without admitting any fault or liability whatsoever. No term or condition of this Agreement is intended to be or shall be deemed or construed as an expression of fault or liability.

2.2. This Agreement contains the entirety of the agreement reached among the Parties pertaining to the subject matter set forth herein. This Agreement supersedes all prior and contemporaneous oral and written Agreements and discussions between or among the Parties except as set forth herein. This Agreement, or any provision hereof, may not be waived, amended or revoked, or the ongoing obligations of any Party terminated, except by a further writing signed by all such Parties.

2.3. This Agreement is the product of negotiation by and among the Parties, executed voluntarily and without duress or undue influence on the part of or on behalf of any Party hereto. Each of the Parties acknowledges that it has had the opportunity to be represented by its own independent counsel in connection with this Agreement and the transactions contemplated by or referred to in this Agreement. Hence, in any construction to be made of this thereof, the same shall not be construed against any Party.

2.4. This Agreement may be executed in any number of counterparts, a complete set of which shall constitute a duly executed original, and fax or electronic signatures shall be treated as originals for all purposes irrespective of any jurisdiction's best evidence rule.

2.5. The failure or delay on the part of any Party to enforce or exercise at any time any of the provisions, rights or remedies in this Agreement shall in no way be construed to be a waiver thereof, nor in any way to affect the validity of this Agreement or any part hereof, or the right of such Party to thereafter enforce each and every such provision, right or remedy. No waiver of any breach of this Agreement shall be held to be a waiver of any other or subsequent breach.

2.6. Each Party shall pay its own attorneys' fees, costs and expenses in connection with the preparation, negotiation and execution of this Agreement. However, in the event of any breach or default of any of the terms and provisions of this Agreement or any disputes regarding interpretation or enforcement of this Agreement, the prevailing Party shall be entitled to recover its reasonable attorneys' fees and costs, in addition to any other award.

2.7. The Parties hereby agree to the following process regarding approval and consummation of this Agreement:

2.7.1. The Debtors shall submit this Agreement to the Bankruptcy Court for final approval in accordance with Federal Rule of Bankruptcy Procedure 9019 within five (5) days of the date of execution of the Agreement by both parties (the "Execution Date").

2.7.2. Medline shall support entry of an order approving the Agreement in good faith, including, among other things, by not objecting to or otherwise commencing any proceeding or taking any other action opposing the terms or implementation of this Agreement or any order approving this Agreement, except as may be consistent with the terms hereof.

2.7.3. If the Bankruptcy Court declines to approve this Agreement despite the best efforts of the Parties to obtain such approval, then (1) this Agreement and its representations and statements shall be null and void and of no force or effect, (2) the Parties' respective rights shall be fully reserved and the Parties shall be restored to their respective positions, *status quo ante*, as existing immediately prior to the Execution Date without prejudice to the passage of time; and (3) unless Medline agrees to continue to supply the Debtors as a Critical Supplier pursuant to the Critical Supplier Order notwithstanding the Bankruptcy Court's failure to approve the Agreement, Medline shall return the Payment to Debtors, in accordance with Section 1.9 of this Agreement.

IN WITNESS WHEREOF, each of the Parties has caused this Agreement to be executed and delivered as of the Execution Date.

Dated: February __, 2019

Verity Health System (Debtor)

By:

Name: _____

Title: _____

Dated: February 20, 2019

Medline Industries, Inc. (Vendor)

By: 

Name: Shane Reed

Title: Director, AIR Services

APPROVED AS TO FORM AND CONTENT:

DENTONS US LLP
SAMUEL R. MAIZEL
JOHN A. MOE, II
TANIA MOYRON

By: _____

Counsel for the Debtor

ARENT FOX LLP

ARAM ORDUBEGIAN
ROBERT M. HIRSH

By: _____

Counsel for the Vendor